BEYOND CHIMERICAL POSSIBILITIES: THE MEANING AND APPLICATION OF ADEQUATE ASSURANCE OF FUTURE PERFORMANCE UNDER THE BANKRUPTCY CODE

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INTRODUCTION

A landlord "should not be permitted to work the forfeiture of a valuable asset of the debtor on the basis of chimerical possibilities."
–In re Sapolin Paints, Inc., 5 B.R. 412, 421 (Bankr. E.D.N.Y. 1980)

One of the first lessons learned in bankruptcy practice is that bankruptcy requires participants to traverse a thicket of jargon. Anyone spending appreciable time with bankruptcy lawyers will soon hear exotic terms batted about. From "indubitable equivalence" to "zones of insolvency," bankruptcy can be an intimidating semantic journey. Understanding the language of bankruptcy, however, is vital not only for a debtor, but also for all interested parties in a bankruptcy case. A bankruptcy court's application of terms unique to bankruptcy can make the difference between a creditor getting paid or a debtor avoiding liquidation. Sometimes the Bankruptcy Code gives parties definitional guidance. Often, it does not. By design, case law is expected to fill the gaps.

An important facet of every business bankruptcy case is how a debtor will deal with contractual agreements between the debtor and non-debtor parties. Whether it is a lease or a supply agreement, these "executory contracts" (another strange bankruptcy term) may be either important assets, or impediments to a successful reorganization. The Bankruptcy Code provides a debtor with the means for maximizing the value of executory contracts through assumption or rejection. Assumption of an executory contract requires the debtor to jump through a number of statutory hoops.[1] Some steps are relatively easy to understand. For example, use of the term "cure"[2] may cause some initial confusion. But, it simply means that, as a condition to continuing under the terms of the agreement as if the bankruptcy filing never happened, the debtor must pay any past due amounts. Another

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[1] *See* 11 U.S.C. § 365(c)(2) (2006) (providing situations where trustee may not assume executory contract); *In re* Marcus Lee Assocs., No. 09-1137bf, 2009 WL 5064315, at *10 (Bankr. E.D. Pa. Dec. 23, 2009) (stating section 365(e)(2)(B) creates exceptions to general rule for termination of contracts because of bankruptcy filing); *see also* Watts v. Pa. Hous. Fin. Co. (*In re* Watts), 876 F.2d 1090, 1096 (3d Cir. 1989) (concluding section 362 does not stay post-filing termination of executory contract to make loan).

[2] *See* Litton v. Wachovia Bank *(In re* Litton), 830 F.3d 636, 644 (4th Cir. 2003) ("[A] cure merely reinstates a debt to its pre-default position, or it returns the debtor and creditor to their respective positions before the default."); *In re* Clark, 738 F.2d 869, 872 (7th Cir. 1984) ("Thus, the plain meaning of 'cure,' as used in section 1322(b)(2) and (5), is to remedy or rectify the default and restore matters to the *status quo ante*."). *See generally* 11 U.S.C. § 1322(b)(2), (5) (2006).

requirement for assumption is not so easily understood. The Bankruptcy Code provides that, in addition to curing past defaults, a debtor must provide the non-debtor party with "adequate assurance of future performance."[3] The Bankruptcy Code does not define this term. Moreover, there has been very little commentary on what exactly this term means.[4] Much of the case law discussing the meaning and application of adequate assurance of future performance dodges a substantive discussion of the term through the incantation of an almost completely unhelpful phrase. That phrase goes something along the lines of: "this requires a fact intensive analysis and therefore it must be decided on [here comes the unhelpful part] a case-by-case basis." A "case-by-case" analysis indicates that a court will consider all of the specific facts of a particular case and apply them in a manner that most reasonably suits those facts. That is how a court applies every legal tenet that comes before it, so it does not provide much guidance, or predictability, to parties in a bankruptcy case. And, such predictability can be a valuable commodity in a bankruptcy case. If, for example, the debtor is a retailer with leased locations all over the country, it would be crucial for the debtor to know whether letters of credit must be obtained for it to provide adequate assurance of future performance to the many different landlords involved in the case. On the other side of the issue, non-debtor parties struggle with how hard they can push for assurances that the financially shaky contractual counterparty will continue to live up to its obligations under the agreement, despite its having to file bankruptcy.

A body of case law has developed that substantively discusses the application of the term "adequate assurance of future performance." Because very few courts of appeal have spoken on this issue, case law rarely provides binding, and therefore certain, guidance. Moreover, there are a number of splits in case law that demonstrate sharp differences of opinion. These caveats aside, however, the case law provides some guidelines and, therefore, some measure of predictability.

This article discusses how courts have interpreted and applied the term "adequate assurance of future performance," as required under section 365(b) of the Bankruptcy Code.[5] Part I discusses, in general terms, the mechanics of assuming an

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[3] *See* 11 U.S.C. § 365(b)(1) (providing in cases of default, trustee must cure or provide adequate assurance of prompt curing); *In re* PRK Enters., 235 B.R. 597, 603 (Bankr. E.D. Tex. 1999) (stating debtor must provide adequate assumption of future performance to assume lease); *In re* Carlisle Homes, Inc., 103 B.R. 524, 538 (Bankr. D.N.J. 1988) ("In order for debtor to assume a contract under § 365(b)(1), it must: (1) cure existing default . . . and (3) provide adequate assurance of future performance under the agreement before assumption will be permitted.").

[4] Aside from practice guides and collections of case law, the only other law review article written specifically on the issue of adequate assurance of future performance, as applied under the Bankruptcy Code, appears to be David B. Simpson, *Leases and the Bankruptcy Code: The Protean Concept of Adequate Assurance of Future Performance*, 56 AM. BANKR. L.J. 233 (1982). *See also In re Carlisle Homes, Inc.*, 103 B.R. at 538 ("The Bankruptcy Code does not define 'adequate assurance'; case law, however, has developed its meaning.").

[5] *See generally* 11 U.S.C. § 365(b). Adequate assurance of future performance is also required under section 365(f)(2)(B). As discussed further in this article, the principal difference between sections 365(b)(1)(C) and 365(f)(2)(B) is that section 365(f)(2)(B) deals with the assignment of an agreement, while section 365(b)(1)(C) deals only with assumption. The different sections raise the issue of whether there must

agreement under section 365, as well as the purpose and intent of that very important section of the Bankruptcy Code. Part II discusses the origin of section 365(b), including the interesting legislative history of section 365(b)(1) and the shopping center provisions of section 365(b)(3). Part III then turns to the specific case law applying section 365(b), including a discussion of standing required to challenge the adequacy of a proffered assurance of future performance, whether a default is required for section 365(b) to apply, and the types of assurances that have, and have not, been found to be adequate. Finally, Part IV discusses the heightened requirements for shopping centers under section 365(b)(3), including how a "shopping center" is defined for the purposes of the section. Part IV also discusses case law that attempts to reconcile the tension between the enforcement of tenant mix and use provisions in shopping center leases, and the unenforceability of anti-assignment provisions under section 365(f). While this look backward at case law applying section 365(b) may not be a perfect predictor of how future courts will rule on these issues, it should provide a greater understanding of the purpose of this requirement.

I. THE ASSUMPTION OF EXECUTORY CONTRACTS UNDER SECTION 365 OF THE BANKRUPTCY CODE

The concept of assumption is set forth in section 365(a) of the Bankruptcy Code. The section provides that "[e]xcept as provided . . . in subsections (b), (c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor."[6] The most commonly accepted definition of the term "executory contract" is that provided by Vern Countryman in his classic 1973 article on the subject.[7] Professor Countryman instructs that an executory contract is "a contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other."[8] The Countryman article discussed the

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be a default for section 365(b)(1)(C) to apply, when the text of section 365(f)(2)(B) makes it clear that the requirement applies whether or not there is a default. This issue is discussed in section III.D.(2) of this article. However, as to the substantive issue of what is required to demonstrate adequate assurance of future performance, the requirements are identical under section 365(b)(1)(C) and section 365(f)(2)(B). Therefore, when this article generally discusses the requirements of adequate assurance of future performance under section 365(b), this should not be taken to mean that these requirements differ from those under section 365(f)(2)(B). *See generally* 11 U.S.C. § 365 (b)(1)(C), (f)(2)(B).

[6] *See* 11 U.S.C. § 365(a).

[7] *See* Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. L. REV. 439, 460 (1973); *see also* Sharon Steel Corp. v. Nat'l Fuel Gas Distribution Corp., 872 F.2d 36, 39 (3d Cir. 1989) (stating Countryman definition of executory contract is definition relied on by courts).

[8] *See* Countryman, *supra* note 7, at 460 (providing definition of executory contract as used in Bankruptcy Act). It should be noted that Countryman's article was written prior to the enactment of the Bankruptcy Code. Moreover, Countryman's article indicates that he was simply summarizing how these pre-Code cases were defining executory contracts, rather than seeking to establish a specific rule of construction. Nevertheless, the Countryman definition has become the "gold standard" for determining whether an

concepts of assumption and rejection before the enactment of the modern Bankruptcy Code in 1978.[9] The concept of assuming or rejecting a contract was adopted by the Bankruptcy Code relatively unchanged from how the terms were used and applied under the Bankruptcy Act of 1898.[10] Moreover, these concepts can be traced back well beyond the Bankruptcy Act of 1898.[11]

At its most basic, rejection allows a debtor to shed itself of burdensome obligations by breaching the agreements, while limiting the breach of contract damages to general unsecured claims.[12] Assumption "permits the [debtor's] estate to obtain the benefits of continued performance by the non-debtor party to the contract, as would assumption by an ordinary contract assignee."[13] Sections 365(b), (c), and (d) provide limitations on a debtor's ability to assume an executory contract.[14] This article focuses on specific limitations set forth in section 365(b). In general, sections 365(b)(1)(A), and (B) require that, in the event of a default, the debtor must promptly cure monetary defaults arising under the executory contract and otherwise must compensate the non-debtor party for pecuniary losses resulting from the default.[15] In addition to these monetary requirements, section 365(b)(1)(C)

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agreement is governed by Bankruptcy Code section 365. *See, e.g., Sharon Steel Corp.*, 872 F.2d at 39 (stating courts rely on Countryman definition of executory contract); Lubrizol Enters. v. Richmond Metal Finishers, Inc. (*In re* Richmond Metal Finishers, Inc.), 756 F.2d 1043, 1045 (4th Cir. 1985) (indicating Fourth Circuit adopted Countryman's definition of "executory contract"); Risa Lynn Wolf-Smith & Erin Connor, *Bankruptcy Considerations in Technology Transactions*, 12 J. BANKR. L. & PRAC. 317, 317 (2003) ("[B]ankruptcy courts apply the Countryman definition to analyzing the unperformed duties of each party and thus determine 'executoriness.").

[9] *See* Countryman, *supra* note 7, at 472 ("There seems to be no recorded instance of attempted assumption or rejection by a receiver for or a trustee of either mortgagor or mortgagee.").

[10] *See* Bankruptcy Act of 1898, ch. 541, 30 Stat. 544, § 70b (1898), *amended by* ch. 575, 52 Stat. 840, 880–81 (1938) (repealed 1978). Bankruptcy Act section 70b read: "Within sixty days after the adjudication, the trustee shall assume or reject any executory contract, including unexpired leases of real property . . . . [T]he court may for cause shown extend or reduce such period of time." *Id.*

[11] *See, e.g.*, Michael T. Andrew, *Executory Contracts in Bankruptcy: Understanding "Rejection,"* 56 COLO. L. REV. 845, 856–63 (1988) (discussing development of case law on subject from 1818 through 1893); James Angell McLaughlin, *Amendment of the Bankruptcy Act*, 40 HARV. L. REV. 583, 606 (1927) (proposing statutory language giving trustee option to adopt executory contracts and leases, yet suggesting "[t]his proviso . . . is thought to be in most part a codification of existing law"); *see also* Palmer v. Palmer, 104 F.2d 161, 163 (2d Cir. 1939) (stating certain doctrinal principles have become "too well fixed to be uprooted, especially since no change was made when the whole subject was overhauled in the Chandler Act").

[12] *See* 11 U.S.C. § 502(g)(1) (2006) (treating claims arising from rejection as if they had arisen pre-petition); *see also In re* Old Carco LLC, 406 B.R. 180, 187 (Bankr. S.D.N.Y. 2009) (acknowledging authority to reject burdensome executory contracts is vital to chapter 11 reorganization); *In re* DMR Fin. Servs., Inc., 274 B.R. 465, 469 (Bankr. E.D. Mich. 2002) (explaining one purpose of rejection is to "relieve the debtor of burdensome future obligations").

[13] Andrew, *supra* note 11, at 847.

[14] *See* 11 U.S.C. § 365(b) (2006) (imposing limitations on assumption where debtor has defaulted on executory contract); 11 U.S.C. § 365(c) (refusing to allow debtor to assume or assign executory contracts under certain situations); 11 U.S.C. § 365(d) (assigning time limits for assumption).

[15] *See id.* at § 365(b)(1)(A)–(B) (discussing curing and compensation in case of default); *see also* C.O.P. Coal Dev. Co. v. C.W. Mining Co. (*In re* C.W. Mining Co.), 422 B.R. 746, 759 (B.A.P. 10th Cir. 2010) ("The right to cure and assume is independent of any state law or contractual provision. Although a debtor's cure rights under section 365 may seem to interfere with the parties' contractual rights, the purpose behind §

requires the debtor to provide the non-debtor party with "adequate assurance of future performance under such contract or lease."[16] Aside from this concise phrase, the Bankruptcy Code provides no further guidance on the meaning of adequate assurance of future performance or how exactly a debtor complies with this obligation.

In the limited situation of leases of real property located in a "shopping center," section 365(b)(3) provides additional guidance. This section provides:

> (3) For the purposes of paragraph (1) of this subsection and paragraph (2)(B) of subsection (f), adequate assurance of future performance of a lease of real property in a shopping center includes adequate assurance —
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> (A) of the source of rent and other consideration due under such lease, and in the case of an assignment, that the financial condition and operating performance of the proposed assignee and its guarantors, if any, shall be similar to the financial condition and operating performance of the debtor and its guarantors, if any, as of the time the debtor became the lessee under the lease;
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> (B) that any percentage rent due under such lease will not decline substantially;
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> (C) that assumption or assignment of such lease is subject to all the provisions thereof, including (but not limited to) provisions such as a radius, location, use, or exclusivity provision, and will not breach any such provision contained in any other lease, financing agreement, or master agreement relating to such shopping center; and
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> (D) that assumption or assignment of such lease will not disrupt any tenant mix or balance in such shopping center.[17]

The final use in section 365 of the term adequate assurance of future performance is in section 365(f)(2)(B).[18] Section 365(f) addresses the assignment of executory contracts. Section 365(f)(1) provides that, where a debtor seeks to assume and assign an executory contract to a third party, any anti-assignment

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365 is to balance the state law contract right of the creditor to receive the benefit of his bargain with the federal law equitable right to have an opportunity to reorganize.") (internal citations and quotation marks omitted).

[16] 11 U.S.C. § 365(b)(1)(C).

[17] *Id.* at § 365(b)(3).

[18] *See id.* at § 365(f)(2)(B) (requiring trustee to assign executory contract or unexpired lease of debtor only if adequate assurance of future performance by assignee of such contract or lease is provided, regardless of existing default).

clauses in the contract are not enforceable, with limited exceptions.[19] Section 365(f)(2) requires that the assignment be in accordance with the other provisions of section 365 and further requires that the assignee provide "adequate assurance of future performance . . . of such contract or lease . . . whether or not there has been a default in such contract or lease."[20] Aside from these three references in section 365, the term "adequate assurance of future performance" is not used in the Bankruptcy Code.[21]

Providing adequate assurance of future performance is therefore a specific, and required, step toward assuming an executory contract. In a broader sense, the policy reasons underlying section 365 as a whole provide a perspective on how this specific requirement fits into the assumption/rejection framework. Section 365 grants a debtor significant powers pertaining to executory contracts; powers that, for the most part, do not exist outside bankruptcy.[22] As noted by cases considering the policies behind section 365, the provisions in section 365(b) provide "a means whereby a debtor can force others to continue to do business with it when the bankruptcy filing might otherwise make them reluctant to do so. The section thus

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[19] Section 365(f)(1) begins with the phrase "[e]xcept as provided in subsections (b) and (c) of this section . . . ." Section 365(c) prohibits a debtor from assigning certain contracts, such as personal service contracts, where otherwise applicable law allows the non-debtor party to refuse to accept or render performance to an entity other than the debtor. As for the reference to section 365(b) made in section 365(f)(1), the specific interaction between section 365(b) and section 365(f) is the subject of a split in the case law, which is discussed further, *infra* in section IV.B. *See infra* pp. [234–40].

[20] 11 U.S.C. § 365(f)(2)(B). As noted by case law, adequate assurance of future performance is required when an agreement is assigned in order to provide "needed protection to the non-debtor party because the assignment relieves the trustee and the bankruptcy estate from liability for breaches arising after the assignment." Cinicola v. Scharffenberger, 248 F.3d 110, 120 (3d Cir. 2001); *see also* 11 U.S.C. § 365(k) (stating trustee's assignment to entity relieves trustee and estate from liability for breaches occurring post-assignment); L.R.S.C. Co. v. Rickel Home Ctrs., Inc. (*In re* Rickel Home Ctrs., Inc.), 209 F.3d 291, 299 (3d Cir. 2000) (explaining adequate assurance of future performance is necessary for assignment by trustee to protect rights of non-debtor party).

[21] Other sections use the term "adequate assurance" (for example section 366(b)), but the term "'adequate assurance of future performance" is limited to the assumption of executory contracts under section 365. *See In re* Am. Home Mortg. Holdings, Inc., 402 B.R. 87, 104 (Bankr. D. Del. 2009) ("Adequate assurance of future performance is a requirement uniquely applicable to executory contracts and unexpired leases subject to section 365 of the Bankruptcy Code."); *see also In re* Nat'l Shoes, Inc., 20 B.R. 55, 59 (Bankr. S.D.N.Y. 1982) (stating adequate assurance of future performance is determined on case-by-case basis). This is in contrast to the similarly-sounding phrase "adequate protection," which is used several times in the Bankruptcy Code (in sections 361, 362(d)(1), 363(e) and 364(d)(1)(B)). In addition to sounding alike, these two phrases seek to protect an interest of the non-debtor party. However, the requirement of adequate protection is generally satisfied by establishing the value of a clear, present (and often physically tangible) interest held by the non-debtor party. In contract, the requirement of adequate assurance of future performance deals with the less tangible, and less predictable, performance of the debtor during some period of time in the future. For a general discussion of adequate protection, see Amy S. Ashworth, Comment, *Adequate Protection – the Equitable Yardstick of Chapter 11*, 22 U. RICH. L. REV. 455, 461–62 (1988) (describing examples of adequate protection in case law).

[22] *See* Andrew, *supra* note 11, at 847 (discussing power to reject*); see also In re* TransAmerican Natural Gas Corp., 79 B.R. 663, 666 (Bankr. S.D. Tex. 1987) (noting Code allows debtor lawful rejection of unfavorable executory contracts); Raymond T. Nimmer, *Executory Contracts in Bankruptcy: Protecting the Fundamental Terms of the Bargain*, 54 U. COLO. L. REV. 507, 519 (1983) (explaining section 365(a) "effectively creates statutory right to breach").

serves the purpose of making the debtor's rehabilitation more likely."[23] The power to "force others to continue to do business"[24] with the debtor is not, however, absolute. Case law also recognizes that section 365 is designed to provide protections to non-debtor parties.[25] In other words, for a debtor to take advantage of the general section 365 framework, it must comply with the requirements set forth in section 365(b). Given the competing interests at stake (rehabilitation of a debtor versus the protection of non-debtor parties), there is a natural tension between how the debtor's powers granted by section 365 are weighed against its responsibilities. This tension is at the core of a court's determination of the degree, and manner, of a non-debtor party's entitlement to adequate assurance of future performance.

II. THE LEGISLATIVE HISTORY OF SECTION 365(B)

A. Section 365(b)(1)(C)

When the modern Bankruptcy Code was enacted in 1978, the concepts of assumption and rejection were not new. As discussed, supra, section 365 was developed in large part from section 70b under the Bankruptcy Act of 1898. The term "adequate assurance of future performance," however, was not drawn from the Bankruptcy Act. The term was new to bankruptcy law, but Congress did not create it for this purpose. Rather, the term was adopted from section 2-609 of the Uniform Commercial Code.[26] The Report on the Commission on the Bankruptcy Laws of the United States (the "Report"), issued in 1973 by the Commission on the Bankruptcy Laws of the United States (the "Commission"), discussed the provision that would eventually be enacted as section 365 and stated: "What constitutes . . . an 'adequate assurance of future performance' must be determined by a consideration of the facts of the proposed "firm commitment" assumption."[27] The Report went on to provide some measure of guidance by noting that "[i]t is not intended, however, that any nondebtor party should acquire greater rights in a case under the [proposed Bankruptcy] Act than he has outside the Act."[28] Bankruptcy case law has

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[23] *In re* Great Nw. Recreation Ctr., Inc., 74 B.R. 846, 854 (Bankr. D. Mont. 1987); *see also In re* Martin Paint Stores, 207 B.R. 57, 62 n.2 (S.D.N.Y. 1997) (stating main goal of 365(b) is to assist in debtor's rehabilitation); *In re* Evelyn Byrnes, Inc., 32 B.R. 825, 829 (Bankr. S.D.N.Y. 1983) (noting Congress' intent to assist debtor in rehabilitation).

[24] *In re Great Nw. Recreation Ctr.*, 74 B.R. at 854 (discussing intent of section 365 to allow debtor to force other party to continue to perform if debtor meets certain requirements).

[25] *See In re* ANC Rental Corp., 280 B.R. 808, 818 (Bankr. D. Del. 2002) (stating section 365 is designed to protect rights of those who share contractual relationships with debtors); *In re* Memphis-Friday's Assocs., 88 B.R. 830, 833 (Bankr. W.D. Tenn. 1988) ("[S]ection 365 . . . is not without protection for lessors and other creditors."). *See generally* William H. Schorling & Robert P. Simmons, *Adequate Protection for the Nondebtor Party to Executory Contracts and Unexpired Leases*, 64 AM. BANKR. L.J. 297, 298–303 (1990) (describing various cases dealing with adequate protection for non-debtors).

[26] *See* U.C.C. § 2-609 (2004).

[27] Report of the Commission on the Bankruptcy Laws of the Untied States, H.R. REP. NO. 93-137, at 156–57 (1973); *cf.* U.C.C. § 2-609 cmt. 4 (1972 ed.).

[28] *See* H.R. REP. NO. 93-137, at 156–57.

recognized that the pedigree of adequate assurance of future performance lies in how the term is used in U.C.C. § 2-609.[29]
Section 2-609(1) provides:

> A contract for sale imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired. When reasonable grounds for insecurity arise with respect to the performance of either party the other may in writing demand adequate assurance of due performance and until he receives such assurance may if commercially reasonable suspend any performance for which he has not already received the agreed return.[30]

Thus, the text of section 2-609 provides some perspective on the use of the term in a commercial context. As noted by the Commission, Official Comment 4 to section 2-609 attempts to provide some measure of guidance on how the term should be applied. Comment 4 provides, in part:

> What constitutes ('adequate') assurance of due performance is subject to the same test of factual conditions. For example, where the buyer can make use of a defective delivery, a mere promise by a seller of good repute that he is giving the matter his attention and that the defect will not be repeated, is normally sufficient. Under the same circumstances, however, a similar statement by a known corner-cutter might well be considered insufficient without the posting of a guaranty or, if so demanded by the buyer, a speedy replacement of the delivery involved.[31]

This commentary sets forth the boundaries of adequate assurance of future performance. Depending on the financial condition of the debtor, and on its past actions, adequate assurance of future performance can range from a simple promise to pay, at one end of the spectrum, to a guaranty of performance (presumably from an independent solvent entity) at the other end. Between these two boundaries, all manner of assurances may be appropriate, given the circumstances. The

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[29] *See, e.g., In re* Grayhall Res., Inc., 63 B.R. 382, 388–89 (Bankr. D. Colo. 1986) (discussing adequate assurance in context of U.C.C. § 2-609). Note also that U.C.C. § 2-609 is not the only provision of the Uniform Commercial Code that has influenced the formation and application of bankruptcy law. For example, Bankruptcy Code section 1110(d)(2) defines a "security interest" to be "a purchase-money equipment security interest." 11 U.S.C. § 1110 (2006). The Bankruptcy Code does not define "purchase-money security interest," but it is clear from the legislative history of the Code that Congress adopted the definition from section 9–103 of the Uniform Commercial Code. *See* 7 COLLIER ON BANKRUPTCY, ¶ 1110.2[1][a][i], at 1109 (Alan N. Resnick et al. eds., 16th ed. rev. 2009) (citing legislative history and case law in support of assertion Congress intended article 9 definition of PMSI).

[30] U.C.C. § 2-609(1).

[31] U.C.C. § 2-609 cmt. 4.

commentary to section 2-609 makes it clear, however, that the subjective "satisfaction" of the party receiving the assurances is not the measure for determining whether adequate assurance has been provided.[32] Rather, commercially reasonable standards are used for making this determination.[33]

There is a small body of commercial case law applying section 2-609.[34] These cases, however, generally involve the simple analysis of the financial condition of the party providing the assurances. As such, this case law is not particularly helpful to bankruptcy, where unique, and often competing, policy considerations are in play. Section 2-609 of the U.C.C. therefore is helpful in that it provides the outer limits of how adequate assurance of future performance should be applied. The specific nuances of its application have come from bankruptcy court decisions.

B. Section 365(b)(3)

Prior to turning to a discussion of this bankruptcy case law, however, another facet of the legislative history of section 365 must be explored. Specifically, the development of the shopping center protections set forth in section 365(b)(3). As quoted, supra, section 365(b)(3) provides special protections to "shopping centers" through a specific definition of adequate assurance of future performance.[35] These special protections were not a part of the original version of section 365, as recommended to Congress in 1973 by the Commission. During the subsequent debate in Congress on the legislation that would become the modern Bankruptcy

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[32] *See id.* ("The adequacy of the assurance given is not measured as in the type of 'satisfaction' situation affected with intangibles, such as in personal service cases involving a third party's judgment as final, or cases in which the whole contract is dependent on one party's satisfaction, as in a sale on approval.").

[33] *See id.* ("[T]he seller must exercise good faith and observe commercial standards."); *see also* Cinicola v. Scharffenberger, 248 F.3d 110, 120 n.10 (3d Cir. 2001) (stating adequate assurance must be defined by "commercial rather than legal standards" (citing Richmond Leasing Co. v. Capital Bank, 762 F.2d 1303, 1309–10 (5th Cir. 1985))); *In re* Pac. Gas & Elec. Co., 271 B.R. 626, 642 (N.D. Cal. 2002) (citing *Richmond Leasing Co.*, 762 F.2d at 1310) (noting commercial standards necessary for adequate assurance determination).

[34] *See, e.g.*, AMF, Inc. v. McDonald's Corp., 536 F.2d 1167, 1170–71 (7th Cir. 1976) (holding assurance inadequate due to AMF's ineptitude); 4 ANDERSON ON THE UNIFORM COMMERCIAL CODE § 2-609:63, at 726–27 & nn.2–3 (3d ed. rev. 2006) (discussing case law providing examples of dependency of sufficiency of adequate assurance on seller's reputation and history); *see also In re* Fleming Cos., 499 F.3d 300, 305–06 (3d Cir. 2007) (citing *In re* Joshua Slocum, Ltd., 922 F.2d 1081, 1092 (3d Cir. 1990)) (applying additional "materially economic and significant" standard to adequate assurance in bankruptcy context); *In re* Carlisle Homes, Inc., 103 B.R. 524, 538 (Bankr. D.N.J. 1988) (addressing difficulty in determining adequate assurance in bankruptcy context). *See generally* Larry T. Garvin, *Adequate Assurance of Performance: of Risk, Duress, and Cognition*, 69 U. COLO. L. REV. 71 (1998) (discussing the development and application of adequate assurance under section 2-609). For additional commentaries discussing section 2-609, see Thomas M. Campell, *The Right to Assurance of Performance Under UCC § 2-609 and Restatement (Second) of Contracts § 251: Toward a Uniform Rule of Contract Law*, 50 FORDHAM L. REV. 1292 (1982). *See also* Gregory S. Crespi, *The Adequate Assurance Doctrine After U.C.C. § 2-609: A Test of the Efficiency of the Common Law*, 38 VILL. L. REV. 179 (1993); R.J. Robertson, Jr., *The Right to Demand Adequate Assurance of Due Performance: Uniform Commercial Code Section 2-609 and Restatement (Second) of Contracts Section 251*, 38 DRAKE L. REV. 305 (1989).

[35] *See supra* text accompanying note 17; *see also* 11 U.S.C. § 365(b)(3) (2006).

Code, the House Judiciary Committee indicated that shopping center leases included provisions that merited special attention.

> A shopping center is often a carefully planned enterprise, and though it consists of nuemrous [sic] individual tenants, the center is planned as a single unit, often subject to a master lease or financing agreement. Under these agreements, the tenant mix in a shopping center may be as important to the lessor as the actual promised rental payments, because certain mixes will attract higher patronage of the stores in the center . . . .[36]

In a 2004 opinion, the Fourth Circuit Court of Appeals analyzed the legislative history of section 365(b)(3) and traced its development of the landlord protections from the initial version enacted in 1978 through the modern version, as amended in 1984.[37] The court noted that prior to 1978, a shopping center landlord was able to protect the tenant mix of its center through the enforcement of an ipso facto clause.[38] In other words, as soon as the tenant filed bankruptcy, the lease would be terminated and the landlord would find "a new tenant that would contribute to an acceptable mix of stores."[39] The bankruptcy legislation being drafted in Congress in 1977 and 1978 indicated, however, that ipso facto clauses would not be enforceable under the new Code. To maintain their control over tenant mix, "shopping center landlords were able to persuade Congress that they needed special protection, which Congress attempted to write into the 1978 Act."[40] This initial attempt, as codified in the Bankruptcy Code enacted in 1978, was not particularly successful from the landlords' point of view. This original version of section 365(c)(3) provided that, to assign a shopping center lease, a tenant was required to provide adequate assurance that "assignment of [the] lease [would] not breach *substantially* any provision, such as a radius, location, use, or exclusivity provision, *in any other* lease, financing agreement, or master agreement relating to such shopping center."[41]

The language used in this version of section 365(b)(3) provided very limited protection to shopping center landlords. Debtors "avoided the 1978 provisions by convincing bankruptcy courts that an assignment would not 'breach substantially' a use, radius, location, or exclusivity provision in another lease."[42] In addition,

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[36] H.R. REP. NO. 95-595, at 348 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6305.

[37] *See* Trak Auto Corp. v. West Town Ctr. LLC (*In re* Trak Auto Corp.), 367 F.3d 237, 242–43 (4th Cir. 2004) (tracking legislative history of Congress's efforts to protect shopping center landlords under the Code).

[38] *See id.* at 242 (stating typical lease allowed landlord to terminate and find new tenants if current tenant went bankrupt).

[39] *See id.* (citing Jeffrey S. Battershall, *Commercial Leases and Section 365 of the Bankruptcy Code*, 64 AM. BANKR. L.J. 329, 329 (1990)).

[40] *Id.* at 242–43.

[41] *Id.* at 243 (quoting 11 U.S.C. § 365(b)(3)) (emphasis added).

[42] *See id.* (discussing dissatisfaction of shopping center landlords with section 365(b)(3) of 1978 Act); *see also* 11 U.S.C. § 365(b)(3)(C) (describing adequate assurance for assumption or assignment of lease of real

"debtors were able to convince courts that even though an assignment that would breach a use provision in the lease sought to be assigned, the assignment could proceed because the 1978 Act only prevented assignment if *some other* lease or agreement relating to the shopping center would be breached."[43] Congress responded, once again, to the concerns of shopping center landlords and amended section 365(b)(3) in 1984 by removing "the word 'substantially' from the provision previously requiring that assignment of a shopping center lease must not 'breach substantially' certain restrictions. This section was also amended to provide that any assigned shopping center leases would remain subject to all of the provisions of 'any other lease' relating to the center."[44]

Therefore, Congress enacted section 365(b)(3) to provide protections to shopping center landlords and then amended the section to provide even stronger protections. This speaks clearly to the importance of these protections. The strong message sent by Congress has been recognized by courts interpreting this section.[45]

III. CASE LAW'S APPLICATION OF ADEQUATE ASSURANCE OF FUTURE PERFORMANCE

A. The Policy Underlying Adequate Assurance of Future Performance – Preserving the Benefit of the Bargain

If it can, in fact, be said that any sort of consensus has emerged regarding the intended policy goals of providing adequate assurance of future performance under section 365(b)(1)(C), it is this: the debtor should provide assurances that preserve the benefit of the bargain reached between the parties at the time the contract or lease was executed. This interpretation of the statute was recognized by the earliest cases discussing adequate assurance of future performance, and future case law has built on this foundation.

One of the first cases to conduct a substantive analysis of the meaning and application of adequate assurance of future performance was *In re Luce Industries*,

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property in shopping center); Battershall, *supra* note 39, at 330 (noting discretion 1978 Act gave bankruptcy courts to approve assignments over objections of lessors).

[43] *In re Trak Auto Corp.*, 367 F.3d at 243; *see also* 11 U.S.C. § 365(b)(3)(C) (stating adequate assurance for assumption or assignment includes no breach of "any other" lease).

[44] *See In re Trak Auto Corp.*, 367 F.3d at 243; *see also* Battershall, *supra* note 39, at 336 (discussing amendment to section 365(b)(3)(C)).

[45] *See, e.g.*, *In re* Joshua Slocum Ltd., 922 F.2d 1081, 1091 (3d Cir. 1990) (reversing bankruptcy court's holding that allowed for shopping center leases to be assigned without including minimum sales provision because "[i]n excising [this provision], the bankruptcy court undermined both the Congressional policy and the statutory requirement under § 365(b)(3)(A) that the trustee give adequate assurance of 'other consideration due' under an unexpired lease"); *In re* 905 Int'l Stores, Inc., 57 B.R. 786, 788 (E.D. Mo. 1985) (quoting report of Senate Judiciary Committee acknowledging "interdependent character of shopping center tenants," as well as type of shopping center agreements section 365(b)(3) is designed to protect); *see also In re Trak Auto Corp.*, 367 F.3d at 244 ("Section 365(b)(3)(C) simply does not allow the bankruptcy court or us to modify [the landlord's] '*original* bargain with the debtor.'" (quoting S. REP. NO. 98-65, at 67–68 (1983)) (emphasis added).

Inc.[46] The case involved Luce Industries ("Luce"), which was a licensee under an exclusive trademark licensing agreement with Fruit of the Loom, Inc.[47] The license agreement provided Luce with the exclusive right to use the Fruit of the Loom trademark in the manufacture of particular types of clothing.[48] After Luce filed for chapter 11 bankruptcy, a dispute arose between Luce and Fruit of the Loom over whether the licensing agreement could be assumed.[49] Fruit of the Loom argued that Luce could not demonstrate that it had the financial wherewithal to perform under the agreement, and that therefore Luce could not establish adequate assurance of future performance.[50] Luce responded that it had entered into agreements (demonstrated by proposals, but not by contracts) with Fashion House, Inc., for manufacturing, and S&S Venture Associates, Ltd., for funding.[51]

Fashion House was a "jobber" who had agreed to provide a sales force and to manufacture the goods pursuant to the terms of the licensing agreement. Luce also argued that Fruit of the Loom was motivated not by a concern over Luce's

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[46] *See In re* Luce Indus., Inc., 8 B.R. 100, 106 (Bankr. S.D.N.Y. 1980), *rev'd*, 14 B.R. 529 (Bankr. S.D.N.Y. 1981) (noting lack of bankruptcy case law on adequate assurance of future performance); *see also In re* Westview 74th St. Drug Corp., 59 B.R. 747, 755 (Bankr. S.D.N.Y. 1986) (treating *In re Luce* as lead case for discussion of adequate assurance of future performance); *In re* Bon Ton Rest. & Pastry Shop, Inc., 53 B.R. 789, 803 (Bankr. N.D. Ill. 1985) (using *In re Luce Indus., Inc.* to explore adequate assurance of future performance). Note that the *Luce* case was not the first Bankruptcy Code case to discuss this issue. Other courts addressed the issue prior to *Luce*. *See In re* Evelyn Byrnes, Inc., 32 B.R. 825, 828 (Bankr. S.D.N.Y. 1983) (addressing adequate assurance of future performance under section 365(b)(1) and section 365(f)(1)); *In re* U.L. Radio Corp., 19 B.R. 537, 542–43 (Bankr. S.D.N.Y. 1982) (concluding assignee gave adequate assurance of future performance to satisfy financial obligations of lease); *In re* Sapolin Paints, Inc., 5 B.R. 412, 424 (Bankr. E.D.N.Y. 1980) (holding adequate assurance of future performance was provided in assignment of lease for office-warehouse building). For a detailed discussion of the *Sapolin Paints* case, see *infra*, section III.C.(1). The *U.L. Radio Corp.* case stressed the importance of preserving the benefit of the parties' bargain. *See In re U.L. Radio Corp.*, 19 B.R. at 543 (noting Congress's concern with adequate assurance providing landlords with full benefit of bargain); *see also* Glen R. Schmitt, *The Bankruptcy Code Requirement of Compliance with Lease Obligations—Does "All" Mean Everything?*, 10 N. ILL. U. L. REV. 225, 233 n.37 (1990) ("In *Radio Corp.*, the court held that the congressional policy behind the adequate assurance provisions was to give lessors the benefit of the bargain."). The case involved a lease of nonresidential real property, and the court noted that the debtor was required to provide adequate assurance of performance of all material provisions under the lease, not just provisions regarding financial obligations. *See In re U.L. Radio Corp.*, 19 B.R. at 543 ("[A]dequate assurance of financial performance is not the complete statutory requirement; adequate assurance of performance is."). The *Evelyn Byrnes* case cited *U.L. Radio Corp.* for the proposition that a landlord must be given the "full benefit of his bargain," but went on to note that "Congress did not mandate that the courts require the assignee to literally comply with each and every term of the lease." *See In re Evelyn Byrnes, Inc.*, 32 B.R. at 829–30 (stating Congress clearly did not mandate courts require assignee to literally comply with every term of a lease). For a discussion of the materiality of provisions, as well as a court's ability to modify a contract in bankruptcy, see *infra* section III.D.(2).

[47] *See In re Luce*, 8 B.R. at 102 (describing agreement between parties).

[48] *See id.*

[49] *See id.* at 101.

[50] *See id.* at 102.

[51] *See id.* at 103.

financials, but rather by a desire to transfer the rights under the agreement to one of Luce's competitors.[52]

The court began its analysis by discussing the legislative history of section 365(b)(1), as well as section 2-609 of the U.C.C.[53] The court drew upon these sources to note that, "[i]n general, the cases and comment reveal an identifiable theme. Section 365(b)(1) attempts to strike a balance between two sometimes competing interests, the right of the contracting non-debtor to get the performance it bargained for and the right of the debtor's creditors to get the benefit of the debtor's bargain."[54] The court quoted the legislative history of section 365(b)(1), which states that "[i]f the trustee is to assume a contract or lease, the courts will have to insure . . . that the trustees' performance under the contract or lease gives the other contracting party the full benefit of its bargain."[55] The court ultimately held that Luce provided Fruit of the Loom with adequate assurance of future performance.[56] It did not concern the court that Luce had no binding contracts with Fashion House,

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[52] *See id.* at 102 (explaining debtor's concern over Fruit of the Loom's scheme to transfer its exclusive license to another company).

[53] *See id.* at 105 (noting Bankruptcy Commission adopted phrase of adequate assurance from U.C.C. § 2-609); *see also* 11 U.S.C. § 365 (b)(1)(C) (2006) (noting trustee cannot assume contract in case of default unless debtor provides adequate assurance); U.C.C. § 2-609 (1) (2004) (indicating party may seek assurance of adequate performance when reasonable grounds for insecurity exist).

[54] *See In re Luce*, 8 B.R. at 107, 107 n.7 (explaining balance that section 365(b)(1) attempts to strike). The court went on to note that "[n]owhere is the tension between these interests, and the difficulty in striking the balance, more apparent than in trying to determine whether there is the requisite adequate assurance of future performance." *Id.* at 107. Subsequent case law has recognized that the balancing of interests is a key component of section 365(b)(1). *See In re* Embers 86th St., Inc., 184 B.R. 892, 896 (Bankr. S.D.N.Y. 1995) (noting section 365(b) aims to promote reorganization by balancing debtor's interest in maximizing value of estate against landlord's interest in receiving benefit of bargain and protection from default); *In re* Carlisle Homes, Inc., 103 B.R. 524, 538 (Bankr. D.N.J. 1988) (positing section 365(b)(1) attempts to balance competing interests of contracting non-debtor and debtor's creditors); *In re Bon Ton Rest. & Pastry Shop, Inc.*, 53 B.R. 789, 803 (Bankr. N.D. Ill. 1985) (highlighting two competing interests that courts must balance). In *In re Southern Biotech, Inc.*, 37 B.R. 311 (Bankr. M.D. Fla. 1983), the court recognized that this balancing act can rise to the level of life and death issues. *See id.* at 312 (suggesting that factual situation of case makes it unique and not "run-of-the-mill" case). In *Southern Biotech*, a chapter 11 Trustee sought to assume a contract between the debtor and the Florida Department of Corrections for the operating of a plasma donor facility at a prison. *See id.* at 313 (noting contract provides Southern Biotech is allowed to open plasma donor-facility at correctional institute). The contract required that the plasma extraction would be conducted in accordance with "good and sound medical practice." *Id.* at 313 (mentioning that contract called for compliance with "good and sound medical practice"). The Florida Department of Corrections argued that the Trustee could not live up to its obligations under the agreement because, at the time (the early 1980s), no one knew exactly how AIDS was transmitted and its affect on plasma. *See id.* at 315. The Department therefore argued that the Trustee could not provide adequate assurance of future performance. *See id.* at 315 ("[S]ince the alpha contract has the provision in which it permits Alpha to terminate this particular contract on 120 days notice, it is conceivable that the entire contract will terminate in five months, therefore, the Trustee will not be able to cure the arrearages."). The court held that the contract could not be assumed because of the interests at stake. *See id.* at 317. The court stated, "[W]hat is to be balanced here is not a potential risk of spreading AIDS against the benefits to society at large through the availability of source plasma, but the benefits to this Debtor which is nothing more than economic benefits matched against the possible serious, and in the case of AIDS fatal, consequences of any infections which might occur as a result of the continuing operating of the plamsapheresis program at the correctional institute." *See id.* at 317.

[55] *See In re Luce*, 8 B.R. at 107 n.7 (quoting House Report No. 95-595, at 348 (1977)).

[56] *See id.* at 107 (concluding Luce met burdens under section 365(b)(1)).

Inc. or S&S Venture Associates Ltd. The court stated that it was not necessary for every detail of a proposal to be "hammered out" in order for a debtor to show adequate assurance of future performance.[57] The court stated that Fruit of the Loom could take comfort in the fact that Luce had a proposal that was not "ephemeral or ethereal," and that "[i]t is a basic presumption in our system of law that parties to a contract will proceed in good faith in fulfilling their contractual obligations."[58] Furthermore, the court noted that no evidence had been presented suggesting that Luce had "a history of defaulting on its obligations, thus mandating a stringent standard in determining the sufficiency of adequate assurance."[59]

Both the *Luce* decision, as well as the legislative history cited in the decision, make it clear that preserving the parties' benefit of the bargain is the overriding goal of section 365(b)(1). While case law uniformly agrees on that issue of law, Fruit of the Loom's appeal of the *Luce* decision also demonstrates that there can be substantial disagreement in the application of the facts to this principle. Fruit of the Loom appealed the bankruptcy court's decision to the district court. In a strongly-worded opinion, the district court disagreed with the bankruptcy court's conclusion that Luce had demonstrated adequate assurance of future performance.

> This conclusion is totally unfounded for several reasons. Most significant of these is that there was not and is not any assurance that the back debt would be paid. No person or corporation had made a firm commitment to furnish the money to the Debtor to pay the debt. Under the facts of this case at least, a firm commitment would be essential to 'adequate assurance' under the statute.[60]

The district court did not dispute the bankruptcy court's finding that a debtor must provide adequate assurance of future performance such that it preserves the parties' benefit of the bargain.[61] However, the district court clearly believed that, under these facts, a "firm commitment" was necessary for Fruit of the Loom to enjoy the benefit of its bargain.[62]

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[57] *See id.* at 108 ("Every single detail need not be hammered out and amplified as it seems Fruit of the Loom desires.").

[58] *Id.*; *see also* U & W Industrial Supply, Inc. v. Martin Marietta Alumina, Inc., 34 F.3d 180, 185 (3d Cir. 1994) (indicating U.C.C. imposes obligation of good faith in performing all contracts); Steven J. Burton, *Good Faith Performance of a Contract Within Article 2 of the Uniform Commercial Code*, 67 IOWA L. REV. 1, 1 (1981) (describing centrality of good faith in U.C.C. contracting rules).

[59] *See In re Luce*, 8 B.R. at 108 (noting Luce had no history of defaulting on obligations).

[60] *See In re* Luce Indus., Inc. 14 B.R. 529, 531 (S.D.N.Y 1981).

[61] *See id.* (noting bankruptcy court recognized need for debtor to cure current default and provide adequate assurance of future payments); *see also In re* Am. Home Mortg. Holdings, Inc., 402 B.R. 87, 104 (Bankr. D. Del. 2009) (explaining adequate assurance is uniquely applicable to executor contracts); *In re* Bronx-Westchester Mack Corp., 4 B.R. 730, 734 (Bankr. S.D.N.Y. 1980) (positing debtor must assume responsibilities such as providing adequate assurance in order to ensure benefit of bargain).

[62] *See In re Luce*, 14 B.R. at 531 (requiring firm commitment for adequate assurance). The district court also expressed its concern that Luce was orchestrating the assignment of an otherwise non-assignable license agreement. *See id.* at 531 ("Essentially, what has taken place here is a court-directed assignment of a non-

Cases subsequent to the *Luce* decision have provided additional guidance on how a debtor can establish that its assurances maintain the parties' benefit of the bargain. Five years after the *Luce* decision, the Bankruptcy Court for the Southern District of New York once again considered the issue, this time in the context of a lease of nonresidential real property. In *In re Natco Industries, Inc.*,[63] the debtor ("Natco") was an operator of 210 retail stores selling men's clothing.[64] After filing bankruptcy, Natco sought to assume the leases on 70 stores.[65] Natco was current on all obligations under the leases, except for certain amounts that were due immediately before the bankruptcy petition date.[66] Natco remained current on all post-petition obligations under the leases, but the business continued to lose money. Natco argued that it had provided the landlords with adequate assurance of future performance through its "virtually flawless" payment history.[67] Natco also pointed to the fact that its principal stockholder provided Natco with a loan for working capital and to fund its plan of reorganization.[68] Certain landlords objected to the assumption, arguing that, among other things, Natco's post-petition business prospects indicated that it would not be able to perform under the leases.[69]

The court considered several issues relevant to adequate assurance of future performance raised by these facts.[70] As to whether Natco had provided the landlords with adequate assurance of future performance, the court noted that the landlords were entitled only to the benefit of their bargain.[71] Specifically, the court wrote that section 365(b)(1) "affords no relief to a landlord simply because it might have the opportunity to rent the premises to others at a higher base or percentage rent and would otherwise seek to escape the bargain it made."[72] The court went on to hold that Natco provided the landlords with adequate assurance of future performance, largely based on the fact that Natco had an almost perfect history of timely rent payments.[73]

While the *Luce* and the *Natco* cases were decided more than twenty years ago, and decided by bankruptcy courts in the same district, these cases represent two

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assignable License Agreement. This is not a case where Luce Industries, as a licensee, continues to manufacture and/or merchandise the trademarked goods. Rather, Luce is now nothing but a conduit. It has no office, no showroom, no sales force, and as far as appears, no leadership; it has delegated everything to Fashion House.").

[63] 54 B.R. 436 (Bankr. S.D.N.Y. 1985).

[64] *Id.* at 438.

[65] *Id.*

[66] *Id.*

[67] *Id.* at 441.

[68] *Id.* at 439.

[69] *See id.* at 439.

[70] *See id.* at 440–41. These issues, including whether demand notes provide adequate assurance of future performance and whether a default must exist for section 365(b)(1) to apply, are discussed later in this article.

[71] *See id.* at 441.

[72] *Id.*

[73] *See id.* (holding debtors paid rent even in troubling times just prior to bankruptcy, leaving "virtually flawless" record).

ends of the spectrum on the issue of preserving the benefit of the bargain. The *Luce* decision – especially the language used by the district court on appeal – makes it clear that a debtor will not be able to assume a lease or executory contract without ensuring that the non-debtor party receives the same assurances it had when the contract was executed. Alternatively, the *Natco* decision makes it equally clear that the non-debtor party cannot use section 365(b)(1) to improve its position, or to get out of an agreement that is not as profitable as it once was. A relatively large body of case law (including cases decided by courts outside of the Southern District of New York) stresses the importance of preserving the benefit of the bargain, within the boundaries set forth by *Luce* and *Natco*.[74]

B. Adequate Assurance Is Easy to Demonstrate . . . Except When It Isn't

The policies underlying section 365(b)(1) have been applied by courts in the context of another bankruptcy policy – the rehabilitation of the debtor.[75] This additional policy consideration may help explain why, in certain cases, the court appears to have set a low bar for establishing adequate assurance of future

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[74] *See, e.g., In re* Fleming Cos., 499 F.3d 300, 306 (3d Cir. 2007) (discussing materiality of provision in supply agreement to determine whether inclusion of term in assumed agreement preserves "overall bargained-for exchange"); *In re* Empire Equities Capital Corp., 405 B.R. 687, 690 (Bankr. S.D.N.Y. 2009) ("These requirements [in sections 365(b)(1)(A)–(C)] are intended to provide the non-debtor party with the benefit of its bargain by assuring substantial compliance with the terms of the contract."); *In re* M. Fine Lumber Co., 383 B.R. 565, 573 (Bankr. E.D.N.Y. 2008) (citing *In re Natco*, 54 B.R. at 440–41) (stating statute does not allow landlords to escape bargains in order to make more money by renting to others at higher prices); *In re* Serv. Merch. Co., 297 B.R. 675, 689–90 (Bankr. M.D. Tenn. 2002) (discussing adequate assurance of future performance in context of shopping center leases under section 365(b)(3) and noting that shopping center tenant must be held to its bargain with landlord); *In re* Mr. Grocer, Inc., 77 B.R. 349, 355 (Bankr. D.N.H. 1987) (acknowledging landlord will still receive economic benefit of bargain because terms and conditions of lease will remain unchanged subsequent to assumption); *In re* Grayhall Res., Inc., 63 B.R. 382, 391–92 (Bankr. D. Colo. 1986) (concluding denial of debtor's request to assume lease would give lessor benefit it had not bargained for); *In re* Westview 74th St. Drug Corp., 59 B.R. 747, 755 (Bankr. S.D.N.Y. 1986) ("The statute [section 365] affords no relief to a landlord simply because it might have the opportunity to rent the premises to others at a higher base or percentage rent and would otherwise escape the bargain it made." (quoting *In re* Natco, 54 B.R. at 440–41); *In re* Bygaph, Inc., 56 B.R. 596, 605 (Bankr. S.D.N.Y. 1986) ("The emphasis is on protection; the assumption and assignment process is not designed to afford a landlord with a benefit in addition to that which he originally bargained for under the original lease." (citing *In re* Webster Clothes, Inc., 36 B.R. 260, 264 (Bankr. D. Md. 1984)). *See generally* William M. Winter, *Preserving the Benefit of the Bargain: The Equitable Result*, 13 BANKR. DEV. J. 543 (1997) (stressing importance of preserving non-debtor's "benefit of the bargain" in midst of debtor's bankruptcy).

[75] *See In re* Evelyn Byrnes, Inc., 32 B.R. 825, 829 (Bankr. S.D.N.Y. 1983) (determining whether adequate assurance of future performance has been provided is "to be made in light of Congress' express policy of favoring assumption and assignment as a means of continuing performance and realizing value and thereby assisting the debtor in its rehabilitation or liquidation"); *see also In re* Seven Hills, Inc., 403 B.R. 327, 334–35 (Bankr. D.N.J. 2009) (stating section 365 "serves to balance state-law contractual rights of creditors – to receive the benefit of their bargain – with the equitable rights of a debtor under bankruptcy law – to reorganize"); *In re Bygaph*, 56 B.R. at 605 (recognizing Congress's intent "to favor assumption and assignment of leases as a means of realizing value for the estate and aiding it in its progress towards rehabilitation" (citing *In re Evelyn Byrnes*, 32 B.R. at 829)).

performance.[76] For example, in *In re Sunrise Restaurants, Inc.*,[77] the court expressly noted that there was "lingering doubt" that the debtor/franchisee of a Burger King franchise agreement would be able to perform. Despite these doubts, the court allowed the debtor to assume the agreement because denying the debtor's motion "would certainly do nothing but visit drastic economic consequences and doom on the entire estate, the secured parties as well as the unsecured [creditors] . . . ."[78] The court went on to explain that "[a]fter all, in the event that [the debtor] defaults, [Burger King] will be in no worse a position than it is today since it will have its right under the contract without any interference from this Court, and in the interim [Burger King] may very well have an economically viable franchise operation . . . ."[79] The *Sunrise Restaurants* case therefore indicates that a court may allow a financially unsound debtor to "give it a shot" when the circumstances of the case make the alternative (denying the motion to assume) particularly unpalatable.[80]

Another example of a court setting a low bar for establishing adequate assurance of future performance is provided by *In re Corporacion de Servicios Medicos Hospitalarios de Fajardo*.[81] This case dealt with a debtor seeking to assume a license to operate a hospital located in Puerto Rico. The Department of Health for the Commonwealth of Puerto Rico (the "Department") opposed the assumption based on a pre-petition audit indicating the debtor was not performing under the license to the satisfaction of the Department.[82] The bankruptcy court granted the debtor's motion to assume, and the district court affirmed the bankruptcy court's order.[83] The Department appealed to the First Circuit, arguing, among other things, that the debtor had not provided it with adequate assurance of future performance.[84] The court acknowledged that at the hearing before the bankruptcy court on the matter of assumption, the debtor provided no separate evidence on the issue of adequate assurance of future performance under section

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[76] *See, e.g.*, discussion *infra* at section III.C.(3). regarding the types of promises that are sufficient to meet the standard and that the requirement under section 365(b) falls far short of a guaranty of payment or performance).

[77] 135 B.R. 149 (Bankr. M.D. Fla. 1991).

[78] *Id.* at 153 (holding notwithstanding doubts as to debtor's ability to perform, debtor should be given opportunity to assume contract in order to prevent consequences on estate and creditors).

[79] *Id.* (noting even if debtor defaults subsequent to assumption, Burger King would still retain its contract right and may even benefit from any viable business conducted in meantime).

[80] *See id.* (suggesting even when doubts exist as to debtor's continued performance under executory contract, courts may be willing to allow assumption when alternative would result in "drastic economic consequences and doom on the entire estate, the secured parties as well as the unsecured"). *But see In re Bygaph*, 56 B.R. at 605 (acknowledging lessor's need for protection from tenants who are likely to default); *In re* Natco Indus., Inc., 54 B.R. 436, 440–41 (Bankr. S.D.N.Y. 1985) ("[T]he obvious purpose of [section 365(b)(1) . . . is to afford landlords with a measure of protection from having to be saddled with a debtor that may continue to default and return to bankruptcy.").

[81] 805 F.2d 440 (1st Cir. 1986).

[82] *See id.* at 441–42 (describing Department's desire to terminate contract with debtor based upon pre-petition audit and evaluation of debtor's operation of hospital under contract).

[83] *See id.* at 442.

[84] *See id.* at 448.

365(b)(1)(C).[85] Rather, the debtor's evidence focused solely on its ability to cure defaults, as required under section 365(b)(1)(A). The bankruptcy court nevertheless found that section 365(b)(1)(C) was satisfied, based on the court's familiarity with the debtor's past performance under the license.[86] The First Circuit, recognizing that the bankruptcy court was the party "most familiar with [the debtor's] operations and financial condition," affirmed the underlying decision.[87] It therefore appears that, given the right set of facts, a debtor may be able to bear its burden[88] under section 365(b)(1) without having to provide any evidence on the point.

Other cases suggest that the *Sunrise Restaurant* and *Fajardo* cases are not aberrations and that adequate assurance of future performance can be an easy standard to establish.[89] Debtors should not, however, take this to mean that courts will automatically give them a pass on establishing adequate assurance of future performance. Parties opposing a debtor's motion to assume are able to point to a number of cases where the debtor was unable to convince the court that it had the financial wherewithal to perform under the agreement. A direct contrast to the *Fajardo* holding permitting the debtor to assume an agreement despite providing no specific evidence on section 365(b)(1)(C) is a decision from the Bankruptcy Court for the Eastern District of Pennsylvania in *In re The Gold Standard at Penn, Inc.*[90] In that case, the court refused to permit a debtor to assume a lease because it had "not provided any specific promises resembling adequate assurance of anything."[91] In another example, the court in *In re THW Enterprises, Inc.*[92] expressed concern that the debtor would be able to establish adequate assurance of future performance in relation to its motion to assume a restaurant lease.[93] This was despite the court's recognition that the default under the lease was "negligible," that the debtor had an "impeccable" payment history, and that the lease was the debtor's most valuable asset.[94] The court allowed the debtor to delay a decision on the issue by granting its

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[85] *See id.*

[86] *See id.*

[87] *See id.*

[88] *See infra* Section III.C.(2); *see also In re* Serv. Merch. Co., 297 B.R. 675, 682 (Bankr. M.D. Tenn. 2002) (noting burden of proof under section 365 is with debtor); *In re* Rachels Indus., Inc., 109 B.R. 797, 802 (Bankr. W.D. Tenn. 1990) ("In a proceeding under § 365, the party moving to assume a lease has the ultimate burden of persuasion that the lease is one subject to assumption and that all requirements for assumption have been met.").

[89] *See, e.g., In re* M. Fine Lumber Co., 383 B.R. 565, 572–74 (Bankr. E.D.N.Y. 2008) (holding debtor could assume lease, conditioned on providing deposit worth four months' rent plus payment of certain taxes, even though debtor acknowledged its pre-petition and post-petition payment history was "less than stellar"); *In re* PRK Enters., Inc., 235 B.R. 597, 600 (Bankr. E.D. Tex. 1999) (finding adequate assurance of future performance even though debtor did not have sufficient cash to pay cure amount all at once); *In re* Prime Motor Inns, Inc., 166 B.R. 993, 997 (Bankr. S.D. Fla. 1994) (stressing assurance required by debtor is simply that it is "more probable than not" debtor will be able to perform in future).

[90] 75 B.R. 669 (Bankr. E.D. Pa. 1987).

[91] *Id.* at 674; *see also In re Rachels Indus.*, 109 B.R. at 813 (denying debtor's motion to assume lease based on fact that debtor's "proof was lacking on the issue").

[92] 89 B.R. 351 (Bankr. S.D.N.Y. 1988).

[93] *Id.* at 357.

[94] *See id.* at 357.

motion to extend the time to assume or reject under section 365(d)(4).[95] As to adequate assurance of future performance, the court made it known that it had "lingering doubt" on the issue, given the lack of evidence on the point provided by the debtor, together with the fact that the debtor had "sustained mounting losses since the filing of its petition . . . ."[96] This case stands as a warning to debtors that an impressive payment history, together with an argument that assumption of the agreement is key to a successful reorganization, may not be enough to convince a court that it should grant the debtor's motion to assume. Other case law bolsters this warning that debtors cannot count on getting a free pass on the issue of adequate assurance of future performance.[97]

C. Navigating the Case-by-Case Determination – Additional Issues Raised by Adequate Assurance of Future Performance Case Law

1. The Method of Analysis – The Sapolin Paints Case

By far, the case most often cited on the issue of what constitutes adequate assurance of future performance is a 1980 case decided by the Bankruptcy Court for the Eastern District of New York, *In re Sapolin Paints, Inc.*[98] If you choose to memorize the case name and facts of one case dealing with adequate assurance of future performance, it should be *In re Sapolin Paints*. This case provides the foundation for the common refrain that an analysis of adequate assurance of future performance must be performed on a case by case basis.

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[95] *See id.* (granting debtor lease assumption option within ninety days from court order entry pursuant to section 365(d)(4) provided adequate assurance of future performance shown); *see also* 11 U.S.C. § 365(d)(4) (2006) (authorizing extension for unexpired nonresidential real property lease assumption upon motion).

[96] *In re THW Enters., Inc.*, 89 B.R. at 357.

[97] *See, e.g., In re* Luce Indus., Inc., 14 B.R. 529, 531 (S.D.N.Y. 1981) (overturning bankruptcy court's finding of adequate assurance of future performance based on lack of firm commitment from outside party to provide funding to debtor); *In re* DBSI, Inc., 405 B.R. 698, 708 (Bankr. D. Del. 2009) (calculating amount necessary for lessee-debtor to maintain property, including mortgage and other expenses, and concluding funds available to debtor were insufficient); *In re* JLS Shamus, Inc., 179 B.R. 294, 297 (Bankr. M.D. Fla. 1995) (concluding debtor could not demonstrate adequate assurance of future performance, based largely on finding debtor could not promptly cure defaults under lease); *In re* Memphis-Friday's Assocs., 88 B.R. 830, 840–41 (Bankr. W.D. Tenn. 1988) (holding lease could not be assumed because it terminated pre-petition, but noting – in dicta –debtor would not have been able to carry its burden of adequate assurance of future performance because it did not provide any evidence it had funds to cure defaults to pay rent going forward); *In re* Future Growth Enters., Inc., 61 B.R. 469, 472 (Bankr. E.D. Pa. 1986) (refusing to allow assumption of lease because debtor's "finances [were] much too precarious"); *In re* Integrated Petroleum Co., 44 B.R. 210, 214–15 (Bankr. N.D. Ohio 1984) (holding debtor could not assume oil and gas lease because debtor had no cash and provided no indication it would receive future income); *In re* Gen. Oil Distribs., Inc., 18 B.R. 654, 658 (Bankr. E.D.N.Y. 1982) (denying debtor's motion to assume agreement for sale of oil to New York City because of debtor's "precarious financial position" and because of importance that city receive uninterrupted oil shipments for Staten Island Ferry and certain waste management facilities); *In re* NPC Realty Co., 7 B.R. 911, 914 (Bankr. S.D. Tex. 1981) (holding in chapter 13 case debtors could not demonstrate adequate assurance of future performance because performance was based on uncertain prospects such as remaining employed and receiving raises to offset inflation).

[98] 5 B.R. 412 (Bankr. E.D.N.Y. 1980).

In re Sapolin Paints involved a paint company debtor ("Sapolin") that filed for chapter 11 bankruptcy, and a subsidiary of the debtor ("Woolsey," together with Sapolin, the "Debtors") that also filed for bankruptcy six days after Sapolin.[99] The Debtors filed a liquidating plan pursuant to section 1123(b)(4) of the Bankruptcy Code.[100] The Debtors held an auction, and the bulk of their assets were sold to United Capital Corp. ("United").[101] United demanded that the Debtors consummate the sale within approximately three weeks after the auction. The Debtors therefore sought a hearing, on five days' notice, seeking an order on their right to assume and assign certain real property leases to United.[102] Arthur Gilbert ("Gilbert") was the landlord for one of the properties (the "California Leasehold"). Sapolin acquired the California Leasehold from another paint manufacturer three years prior to Sapolin filing bankruptcy.[103]

The California Leasehold, located in Los Angeles, included a 69,350 square foot building erected for use by a paint manufacturer.[104] The rental payments on the California Leasehold were significantly below the market rate at the time the petition was filed.[105] This may explain why Gilbert vigorously contested Sapolin's assumption and assignment of the lease to United.

Shortly before the bankruptcy case was filed, Sapolin sublet the California Leasehold to Universal Paint Corp.[106] After purchasing Sapolin's assets at the auction, United designated another company, Metropolitan Greetings, Inc. ("Metropolitan"), as the assignee of the California Leasehold.[107] Therefore, the issue of adequate assurance of future performance turned on whether Metropolitan was able to perform under the lease.[108] The court cited to financial information provided by Metropolitan that strongly suggested it would be able to perform under the

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[99] *See id.* at 414.
[100] *See id.*
[101] *See id.*
[102] *See id.* at 414 & n.1.
[103] *See id.* at 415.
[104] *See id.* at 414–15.
[105] The rent paid by Sapolin was approximately 81 cents per square foot per year. *See id.* at 415. The court noted in its decision that "[t]he prevailing market rate for similar space is $2.88 per square foot." *Id.*
[106] *See id.* at 415.
[107] *See id.* at 416.
[108] *See id.* Adequate assurance of future performance was not the only issue raised by Gilbert. He also argued that the lease had terminated because Sapolin had allegedly allowed the premises on the California Leasehold to remain vacant for a period of time, which was prohibited under the lease. *See id.* The court decided this issue on factual grounds, finding that, even though operations were not taking place on the property for a period of time, the skeleton crew of Sapolin employees that continued to work there satisfied the occupancy requirement under the lease. *See id.* at 419. The court also made short work of a bankruptcy clause in the lease, finding that such clauses were unenforceable under the newly-enacted Bankruptcy Code. *See id.* at 417. The court noted that bankruptcy termination clauses were enforceable under the Bankruptcy Act, and surmised that, "[p]ossibly as balance for the denial of the right to terminate because of bankruptcy, the Code contains far more elaborate provisions than did the Bankruptcy Act . . . governing the assumption and assignment of unexpired leases." *Id.*

lease.[109] This financial information was bolstered by Metropolitan's president who had "no doubt of its ability to make timely payments" called for in the under-market lease.[110]

Despite Metropolitan's firm financial footing, Gilbert argued that Metropolitan could not demonstrate that, going forward, it could satisfy a provision in the lease requiring the tenant to ensure the property would not become vacant or abandoned.[111] The court analyzed whether Gilbert was provided adequate assurance of future performance on this point. The court first noted that the phrase adequate assurance of future performance was "new and was not to be found in the Bankruptcy Act."[112] It continued in its analysis, stating that "[t]he terms 'adequate assurance of future performance' are not words of art; the legislative history of the Code shows that they were intended to be given a practical, pragmatic construction."[113]

The court also cited to section 2-609 of the U.C.C. as the source of additional guidance.[114] The court drew upon these sources to conclude that "[w]hat constitutes 'adequate assurance' is to be determined by factual conditions; the seller must exercise commercial good faith and observe commercial standards; his satisfaction must be based upon reason and must not be arbitrary or capricious."[115]

Having established the baseline for the legal analysis, the court turned back to the specific facts in this case. The court referred, once again, to the fact that this was an "enormously valuable" under-market lease.[116] The court therefore concluded that no reasonable tenant would forfeit such a valuable asset by allowing the property to become vacant.[117] Furthermore, the fact that the lease was significantly under market demonstrated to the court's satisfaction that a tenant would have no trouble leasing the premises at some rate between the lease rate and the market rate of rent.[118] As to Gilbert's fears that the premises would somehow be left vacant or

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[109] Metropolitan "earned in excess of $190,000 for the fiscal year ending December 31, 1979 . . . . It is projected that in the fiscal year ending December 31, 1980, it will earn approximately $1,000,000." *Id.* at 417.

[110] *See id.*

[111] *See id.* at 418–19. The court disputed that there was such an obligation under the lease. *See id.* at 420 (discussing distinction between "covenant" and "condition subsequent" in lease). The court went on, however, to analyze the issue of adequate assurance of future performance under the assumption that such an obligation did exist. *See id.* at 421 (noting adequate assurance of future performance was present here and "economic conditions that tempt Gilbert to question his protection against the possibility that his property will be vacated and abandoned sometime in the indefinite future provide the best assurance that this will not occur").

[112] *Id.* at 417.

[113] *Id.* at 420.

[114] *Id.* at 420–21.

[115] *See id.* at 421.

[116] *See id.* at 418. The court calculated that if the lease were terminated and Gilbert was able to re-let the property at the then-current market rate, he would "realize a windfall in excess of $1,000,000" over the remaining term of the lease. *See id.*

[117] *See id.* at 421 (positing no likelihood Sapolin's assignee would leave property vacant if facing such monetary loss).

[118] *See id.* (downplaying fear that property will remain vacant).

abandoned, the court dismissed them as "not realistic" and accused Gilbert of "seeking to use the legislative concern that landlords be fully protected to bring about precisely the kind of windfall that the statute was intended to prevent."[119] The court concluded with a dramatic flourish, noting that "Gilbert should not be permitted to work the forfeiture of a valuable asset of the debtor on the basis of chimerical possibilities."[120]

A myriad of courts have cited to the *Sapolin* decision for the basic premise that an analysis of whether a debtor provided adequate assurance of future performance must be based on a "pragmatic" balancing of the interests at stake.[121] Proper balancing requires consideration of all facts present in the specific case before the court (hence, the "case by case" incantation). And, the circumstances of the *Sapolin* case demonstrate just how easily different facts could change how a court evaluates the arguments made by the non-debtor party. Consider, for example, the *Sapolin* case in the context of the current downturn in the market for commercial real estate. Such a tweak in the facts changes Gilbert's vacancy concerns from "chimerical" to "inevitable" possibilities. Therefore, while courts make a legal conclusion when deciding whether the standard under Bankruptcy Code section 365(c) has been met, the issue, at the end of the day, is "all about the facts."[122] As discussed above, this seems to suggest that litigants must wander the fact-intensive wilderness with only certain phrases as their guide: preserve the benefit of the bargain, no party is entitled to a windfall, be pragmatic. Unfortunately, this is not entirely untrue. A large part of determining whether a debtor provided adequate assurance of future performance involves understanding Congress's motivation for plucking this phrase out of the Uniform Commercial Code and depositing it into section 365 of the Bankruptcy Code. That is not to say that the fact-filled world of 365(b)(1) case law provides no guidance. Fortunately, courts have encountered facts with sufficient similarity for the litigant to be able to recognize certain recurring patterns.

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[119] *Id.*

[120] *Id.*

[121] *See, e.g.*, *In re* M. Fine Lumber Co., 383 B.R. 565, 572 (Bankr. E.D.N.Y. 2008) (noting term "adequate assurance of future performance" was intended to have pragmatic construction (quoting *In re Sapolin Paints*, 5 B.R. at 420); *In re* Westview 74th St. Drug Corp., 59 B.R. 747, 754 (Bankr. S.D.N.Y. 1986) (stating words "adequate assurance of future performance" were given pragmatic construction by Congress); *In re* Bygaph, Inc., 56 B.R. 596, 605 (Bankr. S.D.N.Y. 1986) (finding "adequate assurance of future performance" is to be determined under facts of each particular case).

[122] *See In re* Natco Indus., Inc., 54 B.R. 436, 440 (Bankr. S.D.N.Y. 1985) (noting history of term "adequate assurance of future performance" was intended to be given construction according to facts of each case); *In re* Evelyn Byrnes, Inc., 32 B.R. 825, 829 (Bankr. S.D.N.Y. 1983) ("[Congress] has entrusted to the courts the determination, on a case-by-case basis, of the meaning of the term 'adequate assurance' . . . ."); *In re* U.L. Radio Corp., 19 B.R. 537, 542 (Bankr. S.D.N.Y. 1982) (stating factual conditions of certain case will determine what constitutes "adequate assurance").

2. Procedural Issues – Burden and Standing

Among the simplest issues in the context of section 365(b)(1) is determining which party has the burden of proof. It is well-accepted that the debtor bears the burden of demonstrating that the assurances of future performance that it has provided to the non-debtor party are "adequate."[123] The non-debtor party, however, bears the burden of establishing that the debtor is in default under the agreement.[124] As discussed, *infra*, a case decided under section 365(b)(1) may very well turn on whether the debtor has, in fact, defaulted under the agreement.

Whether a party has standing to challenge the adequacy of the assurances provided by the debtor is not as simple. This issue was the subject of multiple reported decisions arising out of the same set of facts. The initial case was *In re ANC Rental Corp.*,[125] decided by the Bankruptcy Court for District of Delaware. This case involved debtor ANC Rental Corp. ("ANC") and several of its subsidiaries, including the rental car companies National Car Rental System, Inc. ("National") and Alamo Rent-a-Car, L.L.C. ("Alamo").[126] The Debtors filed Chapter 11 bankruptcy on November 13, 2001, and then filed motions to assume certain agreements to operate car rental concessions at various airports and to assign the agreements to ANC. The assumption and assignment contemplated that, at each airport, one of the agreements would be rejected and the other agreement would be assumed and assigned.[127] Alamo and National would then consolidate their operations at the site and ANC would operate both companies under the same agreement.[128] None of the airports involved objected to this arrangement. Competitors Avis and Hertz did, however, file objections to each of the motions to assume and assign.[129] Avis and Hertz made several arguments under section 365, including arguing that ANC could not show adequate assurance of future performance under section 365(f). The basis of the section 365(f) argument was

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[123] *See, e.g., In re* Rachels Indus., Inc., 109 B.R. 797, 802 (Bankr. W.D. Tenn. 1990) ("In a proceeding under § 365, the party moving to assume a lease has the ultimate burden of persuasion that the lease is one subject to assumption and that all requirements for assumption have been met."); *see also In re* Serv. Merch. Co., 297 B.R. 675, 682 (Bankr. M.D. Tenn. 2002) (noting debtor's burden under section 365 to provide adequate assurance); *In re* Texas Health Enters., Inc., 246 B.R. 832, 834 (Bankr. E.D. Tex. 2000) (stating burden is on debtor to provide adequate assurance of future performance).

[124] *See In re* ALI Props., Inc., 334 B.R. 455, 461 (Bankr. D. Kan. 2005) (stating non-bankrupt party bears burden of proof to assert defaults); *In re* F.W. Rest. Assocs., 190 B.R. 143, 147 (Bankr. D. Conn. 1995) ("Under a strict Section 365(b)(1) analysis, the City bears the evidentiary burden of establishing the Debtor's default under the Concession Agreement. If that burden is met, the Debtor-in-Possession then bears the burden of proof on the issues of prompt cure and adequate assurance of future performance, *inter alia*."); *In re* Diamond Mfg. Co., 164 B.R. 189, 199 (Bankr. S.D. Ga. 1994) (noting burden of proof to establish defaults in agreement is on non-debtor).

[125] 277 B.R. 226 (Bankr. D. Del. 2002).

[126] *See id.* at 229.

[127] *See id.*

[128] *See id.*

[129] *See id.*

that ANC was "merely a holding company" that had never before operated a car rental concession and was incapable of performing under the agreements.[130]

Alamo and National disputed Avis and Hertz's standing to file an objection to the assumption and assignment of the agreements. The court analyzed the issue in the broad context of whether entities that are not parties to the contract at issue have standing to challenge the assumption and assignment of that contract.[131] The court discussed case law analyzing whether other parties have standing to enforce the deadline to assume or reject certain types of leases under section 365(d).[132] Specifically, the court discussed the holding by the Seventh Circuit in *In re James Wilson Associates*.[133] The *James Wilson* court acknowledged that there was a split in authority on standing under section 365(d).[134] Courts allowing a creditor to challenge the assumption of a lease, even when the creditor was not a party to the lease, considered standing "only in its Article III sense: did the creditor have a tangible stake in enforcing the rule?"[135]

The *James Wilson* court acknowledged that such a creditor would have such a tangible stake, but noted:

> [T]here is more to standing. If as here the lessor is content to allow the lease to continue, no other creditors suffer a harm of the kind that the provision was intended to head off. A rule that allows other creditors to complain that the lease was not assumed will simply provoke arid controversies over what formalities should be considered adequate for the assumption of a lease – a matter between the lessor and the lessee.[136]

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[130] *See id.* at 238 (finding debtors presented evidence to establish adequate assurance of future performance by providing evidence establishing debtors had oral license to operate under National and Alamo's trade names).

[131] *See id.* at 230–33 (concluding competitors had no standing).

[132] *See id.* at 231–32 (equating competitors to objector in *In re Martin Paint Stores*, 207 B.R. 57, 61 (Bankr. S.D.N.Y. 1997), where court held objector lacked standing to enforce landlord's rights under lease with debtor, even though objector's rights were affected).

[133] *See id.* at 231–32 (using determination in *In re James Wilson Assocs.*, 965 F.2d 160, 169 (7th Cir. 1992) to conclude Avis and Hertz had no standing).

[134] *See In re James Wilson Assocs.*, 965 F.2d at 169 (discussing split in authority on standing under section 365(d) between First and Second Circuits, and siding with First Circuit); *see also e.g.*, Int'l Trade Admin. v. Rensselaer Polytechnic Inst., 936 F.2d 744, 747 (2d Cir. 1991) (adopting broad interpretation of who has standing to appeal from bankruptcy court ruling under section 365(d)); Pignato v. Dein Host, Inc. (*In re* Dein Host, Inc.), 835 F.2d 402, 406 (1st Cir. 1987) (adopting narrow interpretation of who has standing to appeal from bankruptcy court ruling under section 365(d)).

[135] *In re ANC Rental Corp.*, 227 B.R. at 231 (quoting *In re James Wilson Assocs.*, 965 F.2d at 169); *see also Int'l Trade Admin.*, 936 F.2d at 747 ("[T]he Second Circuit has adopted the general rule, loosely modeled on the former Bankruptcy Act, that in order to have standing to appeal from a bankruptcy court ruling, an appellant must be a 'person aggrieved'—a person 'directly and adversely affected pecuniarily by' the challenged order of the bankruptcy court.").

[136] *In re ANC Rental Corp.*, 277 B.R. at 231 (citing *In re James Wilson*, 965 F.2d at 169) (noting courts will not hear cases from parties suffering injury outside intended scope of laws).

Continuing its analysis of the *James Wilson* case, the *ANC Rental* court further noted that the Seventh Circuit also rejected the argument that Bankruptcy Code section 1109(b)[137] conferred standing on a creditor that was not a party to the lease.

Applying this section 365(d) case law to the broader section 365 issues in the case, the *ANC Rental* court held that neither Avis nor Hertz had standing to challenge the assumption of the concession agreements.[138] The court first noted that neither Avis nor Hertz were even creditors in the case.[139] The court likened them instead to a non-creditor tenant in the *In re Martin Paint Stores* case decided by the District Court for the Southern District of New York.[140] The *Martin Paint* case involved a debtor/tenant in a commercial building that sought to assume and assign its lease to a competitor of the objecting tenant.[141] The *Martin Paint* court held that the objecting tenant did not have standing to challenge the assumption and assignment because the protections of section 365 deal with preserving the benefit of the bargain between the parties to the particular lease at issue, and are not concerned with a third party's bargain with the same landlord.[142]

The *ANC Rental* court ultimately held that Avis and Hertz did not have standing because their interests were interests of competitors and that section 365 was not designed to protect such interests.[143] The *ANC Rental* case therefore stands for the

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[137] *See In re James Wilson Assocs*., 965 F.2d at 169 ("[A]nyone who has a legally protected interest that could be affected by a bankruptcy proceeding is entitled to assert that interest with respect to any issue to which it pertains . . . ."); *In re ANC Rental Corp*., 277 B.R. at 231 (quoting *In re James Wilson Assocs*., 965 F.2d at 169) ("[W]e do not think that [section 1109] was intended to waive other limitations on standing, such as that the claimant be within the class of intended beneficiaries of the statute that he is relying on for his claim, although a literal reading of section 1109(b) would support such an interpretation."); *see also* 11 U.S.C. § 1109(b) (2006) ("A party in interest, including the debtor, the trustee, a creditors' committee, and equity security holders' committee, a creditor, an equity security holder, or any indenture trustee, may raise and may appear and be heard on any issue in a case under this chapter.").

[138] *In re ANC Rental Corp*., 277 B.R. at 231–32 (positing parties here had interests "even less apparent" than parties in *James Wilson* case since parties were not creditors).

[139] *See id*. (stating Avis and Hertz were direct competitors of debtor, not creditors).

[140] *See id.* at 231; *In re* Martin Paint Stores, 207 B.R. 57, 59 (S.D.N.Y. 1997) (describing non-creditor tenant women's clothing store which occupied retail space next to space formerly occupied by debtor).

[141] *See In re ANC Rental Corp*., 277 B.R. at 231 (summarizing non-creditor tenant's claim as one based on possible future damage to non-creditor tenant's business from competitor moving into adjacent space).

[142] *See id.* at 231–32 (holding objector lacked standing to enforce landlord's rights under lease with debtor, even if objector's rights were affected under its own lease); *In re Martin Paint Stores*, 207 B.R. at 61–62 (stating objector lacked standing because it was not a party and had no rights under the lease).

[143] *In re ANC Rental Corp*., 277 B.R at 232 (holding objectors were "merely competitors" and had no direct contractual relationship with the debtors). The court also distinguished the situation from cases involving future asbestos claimants. *See id.* at 232–33. Unlike asbestos claimants, Avis and Hertz would never have a direct claim against the Debtors and there were entities (the airports) that had standing to assert the exact interest that Avis and Hertz were asserting. *See id.* (noting Avis and Hertz will not have future claims adverse to interests of existing creditors like asbestos claimants). Also, as to section 365(f), note that, although the court held that Avis and Hertz had no standing to raise the issue of adequate assurance of future performance under section 365(f), the court went on to analyze the substantive issue. The court cited to the fact that ANC hired former National and Alamo personnel to operate the concessions and that the savings realized by consolidating the concessions would make ANC "much more financially secure than either National or Alamo are today." *Id.* at 238 (finding new operations methods would increase annual savings by almost $4.5 million). In other words, even if Hertz or Avis had standing to challenge whether the Debtors provided adequate assurance of future performance, they would have lost on the issue. *See id.* ("Because . . .

general proposition that a competitor of the debtor does not have standing to challenge whether the assurances provided by the debtor are adequate (or, for that matter, to challenge any other protection provided by section 365). This rather narrow assertion, however, was broadened by a subsequent case decided by the Bankruptcy Court for the District of Delaware when Avis and Hertz raised the same issues in the context of different airports. In the second *ANC Rental* case ("*ANC Rental II*"), Avis and Hertz objected to the Debtors' assumption and assignment of concession agreements at different airports and argued that the first *ANC Rental* case was flawed because, in addition to being competitors, Avis and Hertz were, in fact, creditors of the Debtors.[144] The court clarified its previous decision:

> This fact [that Avis and Hertz were not creditors], however, was not central to our decision on standing. As we noted in the [previous] Opinion, even creditors do not have standing to raise the rights of a landlord or contract party under section 365 . . . . While section 1109 allows a creditor to be heard on any issue in a bankruptcy case, it does not change the general principle of standing that a party may assert only its own legal interests and not the interest of another.[145]

The court therefore concluded, once again, that Avis and Hertz did not have standing to challenge the assumption and assignment of the agreements.[146] The court also dismissed Avis and Hertz's request to be heard on the matter under Bankruptcy Rule 2018(a)[147] on the same basis; the interests that Avis and Hertz were seeking to protect were not "in harmony with the Debtors or the creditors of these estates and [that] there [was] no reason to let Hertz and Avis use this forum to advance their individual interests."[148]

Avis and Hertz appealed the holding to the district court, but to no avail. The district court upheld the bankruptcy court, noting that "[t]he language of section 365 is clearly intended to protect the rights of those persons or entities who share contractual relations with the debtors. In other words, to invoke the protections

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ANC will be able to operate under both names, we conclude that the evidence presented by the Debtors establishes adequate assurance of future performance of the Concession Agreements by ANC.").

[144] *In re* ANC Rental Corp. (*In re* ANC Rental II), 278 B.R. 714, 718 (Bankr. D. Del. 2002) (acknowledging Avis and Hertz were indeed creditors of Debtors).

[145] *Id.* at 719 (reiterating general creditors do not have standing to assert rights of other entities who would be able to challenge this assignment because of their direct interest in matter).

[146] *See id.* ("[A] general creditor such as Avis does not have standing to assert the rights of the Airport Authorities under section 365(c) and/or (f).").

[147] *See id.* (stating parties do not have type of economic interest in case that section 2018 seeks to protect). *See generally* Fed. R. Bankr. Proc. R. 2018(a) (1991). As noted by the court, Rule 2018(a) "allows the Court in its discretion to permit a party to be heard on a matter where it does not otherwise have standing." *See In re ANC Rental II*, 278 B.R. at 719.

[148] *See In re ANC Rental II*, 278 B.R. at 719.

provided in section 365, an entity must be a party to a contract with the debtor."[149] The Third Circuit also upheld the bankruptcy court holding.[150]

3. What Types of "Promises" Are Adequate?

The issue of whether a debtor has provided adequate assurance of future performance often turns on whether the promises made by the debtor, or other relevant parties, are sufficient to meet the requirement under section 365. Case law makes it very clear that a debtor is not required to provide the non-debtor party with a guaranty of performance. In other words, "[a]s designed by Congress, the phrase does not mean absolute assurance that the debtor will thrive and make a profit."[151] The debtor need only provide assurances that, going forward, it will meet its obligations under the agreement.[152] Depending on the debtor's financial outlook, the debtor may, in fact, be required to provide the non-debtor party with tangible assurances such as a deposit or a letter of credit.[153] Many times, however, a debtor

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[149] *In re* ANC Rental Corp., 280 B.R. 808, 818 (D. Del. 2002).

[150] The Hertz Corp v. ANC Rental Corp. (*In re* ANC Rental Corp.), 57 F. App'x 912, 914 (3d Cir. 2003) ("We hold that any claimed loss in market share or profits by Appellants does not result in them being directly and adversely affected pecuniarily, and does not diminish their property, increase their burdens, or impair their rights.").

[151] *In re* Natco Indus, Inc., 54 B.R. 436, 440 (Bankr. S.D.N.Y. 1985); *see also In re* M. Fine Lumber Co., 383 B.R. 565, 573 (Bankr. E.D.N.Y. 2008) ("A debtor need not prove that it will 'thrive and make a profit,' or provide 'an absolute guarantee of performance.") (internal citation omitted); *In re* Alipat, Inc., 36 B.R. 274, 278 (Bankr. E.D. Mo. 1984) ("There is no requirement at law that a proposed assignee must furnish a letter of credit or otherwise absolute guaranty of payment for the full term of an unexpired lease. The 'adequate assurance of payment' element may be provided by a combination of factors . . . .").

[152] *See In re* Texas Health Enters., Inc., 246 B.R. 832, 835 (Bankr. E.D. Tex. 2000) ("Assurance of future performance is adequate 'if performance is likely (i.e. more probable than not)' and the degree of assurance necessary to be deemed adequate 'falls considerably short of an absolute guaranty.'" (quoting *In re* PRK Enters., Inc., 235 B.R. 597, 603 (Bankr. S.D. Tex. 1999))); *In re* Westview 74th St. Drug Corp., 59 B.R. 747, 754 (Bankr. S.D.N.Y. 1986) ("The test is not one of guaranty but simply whether it appears that the rent will be paid and other lease obligations met."); *In re* Bygaph, Inc., 56 B.R. 596, 605 (Bankr. S.D.N.Y. 1986) ("No guarantee is required but the lessor must be given adequate assurance of future performance so that it will be protected from having to take on the burden of a tenant who may be likely to default on his lease obligations after the assumption and assignment . . . ."); *In re* Bon Ton Rest. & Pastry Shop, Inc., 53 B.R. 789, 804 (Bankr. N.D. Ill. 1985) ("[T]he court will not give the lessor herein a guaranty of future performance nor greater rights than it had pre-petition."); *In re Alipat, Inc*., 36 B.R. at 278 ("There is no requirement at law that a proposed assignee must furnish a letter of credit or otherwise absolute guaranty of payment for the full term of an unexpired lease.").

[153] Lifemark Hosps., Inc. v. Liljeberg Enters., Inc. (*In re* Liljeberg Enters., Inc.), 304 F.3d 410, 438–39 (5th Cir. 2002) (noting determination of adequate assurance includes consideration of "whether the debtor's financial data indicated its ability to generate an income stream sufficient to meet its obligations . . . ."); *In re* Berkshire Chem. Haulers, Inc., 20 B.R. 454, 459 (Bankr. D. Mass. 1982) (ruling debtor must show "sufficient likelihood of profitability" in order to provide adequate assurance); *see, e.g., In re* Currivan's Chapel of the Sunset, 51 B.R. 217, 218–19 (N.D. Cal. 1985) (holding $10,000 security deposit placed on assumption of lease was valid exercise of bankruptcy court's equitable powers); *In re* Multech Corp., 46 B.R. 747, 753 (Bankr. N.D. Iowa 1985) (upholding security agreement intended by parties to provide adequate assurance that debtor would perform its future obligations under lease). Examples where a debtor tenant was required to pay a security deposit as part of its assurances of future performance include the following: *In re M. Fine Lumber Co.*, 383 B.R at 575 (requiring debtor to provide landlord with security deposit to ensure

seeks to meet its burden under section 365(b) simply by offering a promise to perform. Whether a court will accept that a promise is sufficient to meet the requirement often depends on the type of promise offered. The spectrum of promises ranges from mere promises to perform to a binding promise by a third party to provide funding to the debtor. The factual circumstances of a case will determine where on this spectrum the line will be drawn between adequate and inadequate assurance of future performance.

An atypical case decided by the Bankruptcy Court for the Middle District of Tennessee demonstrates that adequate assurance of future performance promises come in all shapes and sizes. The case, *In re Yardley*,[154] involved a senior citizen chapter 13 debtor. Prior to filing his petition, the debtor was in an altercation with the apartment complex security guard.[155]

When the security guard confronted the debtor for carrying a lighted cigarette through the lobby, the debtor verbally assaulted the security guard and pulled out a pocket knife.[156] The guard responded by hitting the debtor with his billy club.[157] After the debtor was convicted of criminal assault and fined, the apartment complex sent him a 30-day notice to vacate based on his violation of the complex's rules.[158] The debtor filed bankruptcy and then sought to assume the apartment lease.[159] The court permitted the assumption, based in part on the debtor's promise not to pull a knife on the security guard.[160]

In addition to a promise not to commit criminal assault (again), it is possible to establish adequate assurance of future performance through a mere promise to cure past defaults. For example, in *In re Tama Beef Packing, Inc.*,[161] the chapter 7 trustee for the meat-packing debtor sought to assume and assign a valuable lease between the debtor and the City of Tama, Iowa.[162] The real property was owned by

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adequate assurance); *In re* Lafayette Radio Elecs. Corp., 9 B.R. 993, 1000 (Bankr. E.D.N.Y. 1981) (holding $10,000 security deposit and $10,000 promissory note guaranteeing sublease were adequate assurances); *In re* Belieze Airways Ltd., 5 B.R. 152, 156 (Bankr. S.D. Fla. 1980) ("[A] security deposit of $75,000.00 will provide adequate assurance of future performance . . . ."). In addition, while a guaranty is not required, the presence of a guaranty will weigh in favor of a court finding that adequate assurance of future performance has been established. *See, e.g.*, Richmond Leasing Co. v. Capital Bank, 762 F.2d 1303, 1310 (5th Cir. 1985) ("Courts have consistently determined whether a debtor offered adequate assurance of future performance by considering whether the debtor's financial data indicated its ability to generate an income stream sufficient to meet its obligations, the general economic outlook in the debtor's industry, and the presence of a guarantee."); Ramco-Gershenson Props., L.P. v. Serv. Merch. Co., 293 B.R. 169, 177–78 (Bankr. M.D. Tenn. 2003) (deferring to bankruptcy court's findings of fact that assurances were adequate where exhibits showed guaranty existed). *But see, e.g., In re* Memphis-Friday's Ass'ns., 88 B.R. 830, 841 (Bankr. W.D. Tenn. 1988) (finding no adequate assurance when only evidence was statement produced at trial that debtor "'of course' stood ready . . . to honor its guaranty of the lease obligations").

[154] 77 B.R. 643 (Bankr. M.D. Tenn. 1987).

[155] *Id.* at 644.

[156] *Id.*

[157] *Id.*

[158] *Id.*

[159] *Id.*

[160] *Id.* at 646.

[161] 277 B.R. 407 (Bankr. N.D. Iowa 2002).

[162] *Id.* at 408.

the City of Tama and the debtor located its processing facility on the property.[163] Two different parties bid for the right to have the lease assigned to them and the trustee selected the best offer, made by Iowa Quality Beef Supply Network.[164] As to the requirements under section 365(b), the court noted that the parties offered nothing more than a promise to cure defaults.[165]

It was clear, however, that Iowa Quality Beef Network was an established entity that would be able to perform. The court noted that, "[a]dmittedly, under different facts, a simple recitation of a willingness to cure a default absent other assurances may be inadequate. However, the background of this case convinces the Court that the criteria are adequately met."[166] As demonstrated by the qualified language used in the *Tama* case, a court analyzing whether a debtor provided adequate assurance of future performance will typically require more than a simple promise to cure defaults and perform under the agreement.[167]

Where a simple promise to perform is not sufficient, it is not unusual for a debtor to use a third party's offer to provide funding to demonstrate adequate assurance of future performance. Courts have generally accepted such promises as sufficient proof to meet the standard under section 365(b), but courts differ on whether the promise to pay (i.e., the loan) is a binding offer and on whether the party making the loan has the right to demand repayment at any time.[168] The issue was framed in one of the first cases to substantively discuss adequate assurance of

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[163] *Id.* at 408–09.

[164] *Id.* at 410–11.

[165] *See id.* at 411–12 (stating trustee agreed to assign lease to Iowa Quality Beef Supply Network and Iowa Quality Beef Supply Network promised to cure defaults in lease); *see also* 11 U.S.C. § 365(b) (2006) (mandating trustees not assume lease unless they give adequate assurance default will be cured, other party to contract will be compensated for pecuniary loss, and there will be future performance of lease).

[166] *In re Tama Beef Packing*, 277 B.R. at 412. Another example is provided by *In re* PRK Enters., Inc., 235 B.R. 597 (Bankr. E.D. Tex. 199). This case involved a debtor seeking to assume certain leases of property where it operated Dairy Queen restaurants. *Id.* at 599. The court permitted the debtor to assume the leases, even though the debtor lacked sufficient funds to pay the cure amount in one lump sum. *Id.* at 600. The court noted that two officers of the debtor had agreed to forego their salaries to apply to the proposed cure installment payments. *Id.* The court held that section 365(b) was met, in part, because the officers had demonstrated that they were "serious in their commitment to rehabilitate this corporation." *Id.* at 603.

[167] *See, e.g., In re* The Gold Standard at Penn, Inc., 75 B.R. 669, 674 (Bankr. E.D. Pa. 1987) (refusing to approve assumption of lease because "Debtor here has not provided any specific promises resembling adequate assurance of anything"); *In re* Integrated Petroleum Co., 44 B.R. 210, 214 (Bankr. N.D. Ohio 1984) (denying debtor's motion to assume oil and gas lease because debtor promised to use cash reserve to cure defaults, but did not have cash reserve). *But see In re* Bronx-Westchester Mack Corp., 20 B.R. 139, 142 (Bankr. S.D.N.Y. 1982) (permitting debtor to assume and assign distribution agreement based on assignee's promise to perform and financial stability).

[168] *See In re* M. Fine Lumber Co., 383 B.R. 565, 570 (Bankr. E.D.N.Y. 2008) (allowing debtor to assume lease partly because of financing agreements with two separate parties); *see also In re* Natco Indus. Inc., 54 B.R. 436, 441 (Bankr. S.D.N.Y. 1985) (finding demand nature of loan not determinative). *But see In re* Res. Tech. Corp., No. 08 C 2425, 2008 WL 4876846, at *5 (N.D. Ill. Nov. 7, 2008) (suggesting although loan was payable on demand in *In re Natco*, debtor's good payment history and few defaults may explain why adequate assurance was found); *In re* Luce Indus., Inc., 14 B.R. 529, 531 (Bankr. S.D.N.Y. 1981) (finding no adequate assurance by debtor because potential lender made no "firm commitment" to fund).

future performance. In *In re Natco Industries, Inc.*,[169] the Bankruptcy Court for the Southern District of New York approved the retail debtors' motion to assume the leases on certain stores, based largely on the agreement of the debtors' major stockholder, Pisers Leasing Company, to make a loan to the debtors.[170] The debtors asserted that the loan gave adequate assurance of future performance because it would assist the debtors in emerging from bankruptcy and in funding their future operations.[171] The loan was payable to Pisers Leasing Company on demand.

The court performed a detailed analysis of whether the debtor provided the landlords with adequate assurance of future performance. Its ultimate holding was based mainly on the debtor's "virtually flawless" payment history.[172] The court determined that, given the facts at hand, "there [was] every indication that the rent reserved in these leases will be paid."[173] As to the demand loan issue, the court noted:

> The demand nature of the Pisers loan hardly contradicts such an assessment [that rent will be paid]. To hold otherwise would effectively require most, if not all, debtors-in-possession who lease real estate to obtain financing on a non-demand basis. There is no indication that Congress sought such a result. Indeed, section 364 of the Code, pursuant to which a debtor-in-possession may obtain credit, contains no such requirement. That the financing may continue post confirmation is also of no moment. Chapter 11 financing is often the basis for permanent financing.[174]

Therefore, according to the *Natco* court, a promise to pay is not illusory simply because the loan must be repaid by the debtor on demand.[175]

Other more recent decisions have agreed that funding on limited terms is sufficient to establish adequate assurance of future performance. For example, in *In re M. Fine Lumber Co.*,[176] the Bankruptcy Court for the Eastern District of New York allowed the debtor to assume a lease of property where it operated a lumber yard, even though the debtor's payment history was "less than stellar," an eviction notice for failure to pay rent was pending when the case was filed, the debtor was unable to pay accrued post-petition administrative expenses, and the United States

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[169] 54 B.R. 436 (Bankr. S.D.N.Y. 1985). For a discussion of the facts in the *Natco* case, see *supra* section III.A.

[170] *Id.* at 439.

[171] *See id.* at 438–39 ("To fund the Plan and provide working capital, [the debtors] have arranged for a $5 million loan from a major stockholder . . . which is payable on demand.").

[172] *Id.* at 441.

[173] *Id.*

[174] *Id.*

[175] *Id.* (taking debtor's reliable payment history and Piser's vested interest in debtor into account, court found adequate assurance regardless of loan being payable on demand).

[176] 383 B.R. 565 (Bankr. E.D.N.Y. 2008).

Trustee had filed a motion to convert to a chapter 7 case.[177] The court's decision was based, in part, on the fact that the debtor had obtained financing agreements from two separate parties. One agreement provided that the funds would be available for no longer than six months.[178] The other agreement guaranteed the debtor's rent payments, but only until a plan was confirmed.[179] These limited-term loans contributed to the court's finding that adequate assurance of future performance was provided.[180] However, given the financial instability of the debtor, the court also required the debtor to provide a security deposit worth four months' rent.[181]

While some courts find limited promises to provide funding sufficient to meet the requirement under section 365(b), other courts disagree. As discussed in section III.A *supra*, in *In re Luce Industries*,[182] the District Court for the Southern District of New York held that the bankruptcy court's finding of adequate assurance of future performance was "totally unfounded."[183] This holding was based, in large part, on the fact that the financing proposals offered by the debtor were not "firm commitments" to provide funding.[184] The court stated that, "[u]nder the facts of this case at least, a firm commitment would be essential to 'adequate assurance' under the statute."[185] The court noted that the apparel manufacturing debtor had a significant amount of back debt and that, to establish adequate assurance of future performance, the debtor had to show that it had lined up firm financing to pay this debt.[186]

Likewise, in *In re Resource Technology Corp.*[187] the District Court for the Northern District of Illinois refused to find that a debtor operator of landfills provided adequate assurances that it would be able to perform certain contracts giving the debtor the exclusive right to install gas-to-energy conversion projects at the landfill.[188] The debtor intended to assume and assign the contracts to the Illinois Investment Trust ("IIT"). IIT was a trust whose beneficiaries were the debtor's secured creditors. The bankruptcy court conducted a trial on whether IIT could provide adequate assurance of future performance. At the time of the trial, IIT had

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[177] *See id.* at 567–68, 572.

[178] *See id.* at 570 (noting agreement provides additional $100,000 borrowing facility available to debtor to be used for working capital and to provide adequate assurance of future performance). This loan, known as the "Greystone Agreement," was provided by the debtor's post-petition lender. *See id.* The Greystone agreement was secured by a mortgage on the house of the debtor's principal. *See id.*

[179] *See id.* at 571. This loan, known as the "NY Timber Agreement" was made by a company whose principal was the son of the debtor's principal. *See id.*

[180] *See id.* at 575.

[181] *See id.* (remarking if case is converted, landlord will receive rent payments while trustee finds buyer for lease).

[182] 14 B.R. 529 (Bankr. S.D.N.Y. 1981).

[183] *See id.* at 531 (concluding bankruptcy judge was wrong when he concluded debtor-in-possession had shown willingness and ability to succeed).

[184] *See id.* (discussing no person made firm commitment to furnish money to debtor to pay debt).

[185] *Id.*

[186] *Id.* at 531 (emphasizing assurance and firm commitment of the repayment of back debt was missing).

[187] No. 08 C 2425, 2008 WL 4876846, at *1 (N.D. Ill. Nov. 7, 2008).

[188] *See id.* at *5 (affirming decision of bankruptcy court finding IIT failed to provide adequate assurance showing it could perform Landfill Contracts).

less than $1,000 in cash, no financial statements, and no operating history. IIT asserted that it would be able to perform under the contracts because it would receive operating funds from the secured creditors.[189] The secured creditors promised to loan IIT money to provide funding, but their testimony at the trial demonstrated that they were not obligated to fund. Furthermore, the secured creditors offered no evidence they had sufficient funds to make the loan. On appeal, the district court noted that other cases allowed the assumption of contracts on the basis of limited funding agreements.[190] But, the court distinguished those cases on the grounds that the debtor in this case had no demonstrated history of performance[191] and that the secured creditors demonstrated no ability to provide the funds.[192] The court instead likened the facts to other cases where courts refused to find adequate assurance of future performance based on prospective lenders who were unable, or unwilling, to demonstrate they had sufficient funds available to provide to the debtor.[193]

In addition to discussing the issue of loans offered by parties that have not demonstrated an ability to perform, the *Resource Technology* court also touched on the issue of assurances made by a company with no operating history.[194] While the holding of *Resource Technology*, turned on the financial wherewithal of the secured creditors, the court noted that "IIT, however, had never operated any sort of business."[195] Presumably, this fact contributed to the court's requirement that outside parties (the secured creditors) provide proof that IIT would have the ability to perform under the agreement. In other words, evidence of outside funding was required because the court could not rely upon IIT's previous operational performance.

Other courts have addressed this "new business" issue in greater detail. In *In re Lafayette Radio Electronics Corp.*,[196] the court considered the issue in the context of a retail debtor seeking to assume a lease and sublet it to another party. The proposed sublessee, Sublime Sales Corporation ("Sublime"), was a subsidiary of companies doing business under the trade name "Labels for Less."[197] Sublime was a "shell company" created for the "sole purpose" of entering into this lease.[198] Sublime therefore had no operating history for the court to analyze in determining

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[189] *See id.* at *1 (arguing creditors would loan necessary funds to IIT).

[190] *See id.* at *5 (citing cases where courts determined adequate assurance of future performance was met).

[191] *See id.* ("The debtor in that case . . . had a long history of performing on the contracts in question, and [that] past defaults had been minor." (citing *In re* Natco Indus., Inc., 54 B.R. 436, 441 (Bankr. S.D.N.Y. 1985))).

[192] *See id.* at *5 (contrasting case with *In re* Bygaph, Inc., 56 B.R. 596, 605 (Bankr. S.D.N.Y. 1986), where testimony was offered "reflecting an investor's . . . willingness to fund a putative assignee").

[193] *See id.* ("Courts have denied motions to assume and assign contracts based on facts similar to the current case." (citing to *In re* Wash. Capital & Aviation Leasing, 156 B.R. 167, 175 (Bankr. E.D. Va. 1993) and *In re* Embers 86th St., Inc., 184 B.R. 892, 901–02 (Bankr. S.D.N.Y. 1995))).

[194] *See id.* at *1 (stating IIT had no operating history).

[195] *Id.*

[196] 9 B.R. 993, 1000 (Bankr. E.D.N.Y. 1981).

[197] *Id.* at 996.

[198] *See id.*

whether it could, and would, perform under the lease. The court first noted that Sublime had given the debtor a $10,000 security deposit and a $10,000 note.[199] This very likely contributed to the court's ultimate holding that adequate assurance of future performance was provided. However, as to Sublime's lack of operational history, the court analyzed the financial status of the Labels for Less companies. The court found that these companies were operating at a profit and had a "viable business future."[200] The holding in *Lafayette Radio* therefore indicates that, when a company has no operational history, a court will look to its parent company, principal, or other financial backers, to determine whether the new company will be able to demonstrate adequate assurance of future performance. Cases decided after *Lafayette Radio* have followed this logic.[201]

D. Defaults

1. Does Section 365(b)(1)(C) Apply if There Has Been No Default?

The text of section 365(b) suggests that it applies only when there has been a default in the agreement at issue.[202] Section 365(b) is structured such that sections 365(b)(1)(A), (B), and (C) set out the various requirements that a debtor must meet to assume an executory contract or lease.[203] Section 365(b)(1) begins, however, with the qualification: "If there has been a default in an executory contract or unexpired lease . . . ."[204] The logical interpretation of this text is that if there has not been a default, then the debtor is not required to jump through the statutory hoops set forth in sections 365(b)(1)(A) through (C).[205]

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[199] *See id.*

[200] *See id.* at 1000.

[201] *See In re* Serv. Merch. Co., 297 B.R. 675, 682 (Bankr. M.D. Tenn. 2002) ("In this case, the assignee's future performance is to be judged, *inter alia*, by the financial strength of its backers, and its operating performance is to be judged by its principal's operating performance."); *In re* Casual Male Corp., 120 B.R. 256, 265 (Bankr. D. Mass. 1990) ("Because [the proposed assignee] was recently incorporated, any judgment concerning the strength of its operating performance necessarily depends upon the business experience of York, its sole owner and chief executive officer."); *see also In re* Greektown Holdings, L.L.C., No. 08-53104-wsd, 2009 Bankr. LEXIS 1231, at *5 (Bankr. E.D. Mich. May 13, 2009) ("Under the statute, the cure and other stated requirements incident to an assumption only come into play if the debtor is in 'default.'"); *In re* Barnhill's Buffet, Inc., No. 07-08948, 2008 Bankr. LEXIS 2864, at *6 (Bankr. M.D. Tenn. Feb. 28, 2008) (examining factors of adequate assurance, including backing by another corporation with significant "tangible liquidity").

[202] *See* 11 U.S.C. § 365(b)(1) (2006) ("If there has been a default in an executory contract or unexpired lease of the debtor, the trustee may not assume such contract."); *In re* UAL Corp., 293 B.R. 183, 190 (Bankr. D. Ill. 2003) ("[T]he requirement of adequate assurance is applicable only in the event that the debtor is in default under the contract it is seeking to assume.").

[203] *See generally* 11 U.S.C. § 365(b)(1)(A)–(C) ("[T]he trustee may not assume such contract or lease unless . . . the trustee (A) cures, or provides adequate assurance that the trustee will promptly cure . . . (B) compensates, or provides adequate assurance that the trustee will promptly compensate . . . and (C) provides adequate assurance of future performance . . . .").

[204] 11 U.S.C. § 365(b)(1).

[205] *See* COLLIER ON BANKRUPTCY, ¶ 365.05[1], at 365–53 (Alan N. Resnick et al. eds., 16th ed. rev. 2009) ("By its terms, section 365(b) applies only when there has been a default. If there has been no default, the

As to adequate assurance of future performance – the requirement set forth in section 365(b)(1)(C) – this viewpoint is bolstered by the fact that section 365(f), dealing with the assignment of an executory contract or lease, states that "adequate assurance of future performance by the assignee of such contract or lease [must be] provided, whether or not there has been a default in such contract or lease."[206] It seems fairly clear, therefore, that if there has not been a default under an agreement, the debtor is not required to show adequate assurance of future performance if it is seeking only to assume the agreement, but is required to make the showing if it is seeking to assume and assign the agreement.

Not surprisingly, courts have followed the plain language of the statute and have held that debtors are not required to provide adequate assurance of future performance when they are seeking to assume an agreement that is not in default.[207] In addition to following the plain text of the statute, this also is in accordance with the legislative history of section 365. As observed by the Bankruptcy Court for the Southern District of New York in the *Natco* decision, the requirements set forth in section 365(b)(1) were enacted, in part, because, in enacting section 365(e)(1), Congress voided bankruptcy default clauses that were valid under the Bankruptcy Act.[208] The section 365(b)(1) requirements, therefore, sought to provide protections to non-debtor parties who no longer could enforce a bankruptcy default clause.

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trustee or debtor need not comply with the cure, compensation, and adequate assurance requirements of section 365(b)."); *see also In re UAL Corp*., 293 B.R. at 190 (stating assumption requirements under statute are only necessary if there has been default); *In re Greektown Holdings*, 2009 Bankr. LEXIS 1231, at *5 (concluding assumption requirements need only be discussed if in default). Practically speaking, this issue only applies to section 365(b)(1)(C). Sections 365(b)(1)(A) and (B) set forth requirements for the debtor to cure defaults and to pay for pecuniary losses from defaults. *See* 11 U.S.C. § 365(b)(1)(A)–(B) (providing ways in which trustee can provide adequate assurance and cure default). If there has been no default, then clearly the debtor has no obligations under sections 365(B)(1)(A) and (B). *See In re* Goldblatt Bros., Inc., 766 F.2d 1136, 1140 (7th Cir. 1985) (determining no cure and compensation was required because no default occurred); *see also In re* Rachels Indus., Inc., 109 B.R. 797, 803 (Bankr. W.D. Tenn. 1990) (positing adequate assurance not necessary if no default exists); *In re* Natco Indus., Inc., 54 B.R. 436, 440 (Bankr. S.D.N.Y. 1985) (reasoning no default existed; therefore assumption of executory contract does not require curing or providing adequate assurance, only business judgment).

[206] 11 U.S.C. § 365(f)(2)(B).

[207] *See In re Rachels*, 109 B.R. at 803 ("[W]here there has been *no* default, the provision of adequate assurance of future performance is not necessary."); *In re* Sluss, 107 B.R. 599, 604 (Bankr. E.D. Tenn. 1989) ("[A]dequate assurance is required when there is a default [but the] debt to [the non-debtor party] is not a default as far as the court can tell."); *In re* Great Nw. Rec. Ctr., Inc., 74 B.R. 846, 854–55 (Bankr. D. Mont. 1987) (analyzing whether debtor was in default under franchise agreement to determine whether debtor was required to show adequate assurance of future performance); *In re* Grayhall Res., Inc., 63 B.R. 382, 389 (Bankr. D. Colo. 1986) ("If there are no defaults under the contract sought to be assumed, there is no statutory mandate for the debtor to have to provide 'adequate assurance of future performance' before assumption."); *In re* Westview 74th St. Drug Corp., 59 B.R. 747, 754 (Bankr. S.D.N.Y. 1986) ("In the absence of a default, the debtor is entitled as a matter of course to assume a lease which appears to be in the best interests of the estate."); *In re* Ridgewood Sacramento, Inc., 20 B.R. 443, 445 (Bankr. E.D. Cal. 1982) ("The language of this subsection as well as the legislative history . . . requires that the obligation be in default at the time that the trustee or the debtor-in-possession assumes the executory obligation in order for adequate assurances to be required.").

[208] *In re Natco*, 54 B.R. at 440–41(noting "statutory voiding of bankruptcy default clauses contained in § 365(e)(1)" affords landlords protection).

However, because the primary concern that section 365(b)(1) seeks to address is the "protection from having to be saddled with a debtor that may continue to default and return to bankruptcy,"[209] the section only applies when, in fact, defaults are an issue.

While courts seem to agree there must be a default for section 365(b) to apply, that does not mean that, in the absence of a default, courts are prohibited from requiring the debtor to demonstrate adequate assurance of future performance. An early case decided by the District Court for the Northern District of California indicates that bankruptcy judges have the power to impose such a requirement. In *In re Currivan's Chapel of the Sunset*,[210] the court required the debtor to provide a $10,000 deposit as a condition to assuming the lease on the property on which it ran its mortuary business. The debtor pointed out it was not in default under the lease, and argued that section 365(b) "authorizes the court to require assurance of future performance under a lease to be assumed only if there has been a default."[211] The bankruptcy court disagreed, holding that section 105 of the Bankruptcy Code provided the court with the power to impose such a requirement.[212] On appeal, the district court agreed and affirmed the bankruptcy court's holding.[213] In doing so, the district court noted that there is "no specific prohibition against imposing conditions on assumption of a lease or contract in the absence of a default."[214] The court further agreed that the bankruptcy "court's equitable powers are broad" and that section 105 provided a firm statutory basis for the court's actions.[215]

2. Any Default, or Only "Material" Defaults?

As discussed above, the presence of a default, under normal circumstances, will determine whether adequate assurance of future performance must be provided under section 365(b). A number of cases analyzing section 365(b) therefore focus on the threshold issue of whether there has been a default and whether it is a material default. The courts agree that state law governs whether there has been a default under the terms of an agreement – whether it is an executory contract or

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[209] *Id.* at 441; *see also In re Grayhall*, 63 B.R. at 389–90 (holding non-shopping center lessor "had no realistic expectation of an assured income stream from the lease" because the lessee had right to terminate lease on 30 days' notice, and contrasting those circumstances to "a lessor of a shopping center [who] has incurred great debt and needs the rents to pay the mortgage"); *In re* Evelyn Byrnes, Inc., 32 B.R. 825, 830 (Bankr. S.D.N.Y. 1983) ("The express adoption of these concepts [in section 365(b)(3)] by Congress only with respect to shopping centers strongly indicates that Congress desired greater flexibility in the assumption and assignment of other leases."); *In re* U.L. Radio Corp., 19 B.R. 537, 544 (Bankr. S.D.N.Y. 1982) ("The Court's authority to waive strict enforcement of lease provisions in the non-shopping center cases will permit deviations which would exceed those permitted in the shopping center cases.").

[210] 51 B.R. 217 (N.D. Cal. 1985).

[211] *Id.* at 218.

[212] *Id.* (noting bankruptcy court's holding that section 105 gave it authority to issue "any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title").

[213] *Id.*

[214] *Id.* at 219.

[215] *See id.* at 218 (noting bankruptcy court has broad authority to carry out provisions of 11 U.S.C. § 105).

lease.[216] The case law diverges on the issue of whether section 365(b) applies where any default has occurred, or whether the non-debtor party must provide adequate assurance of future performance only when there has been a material default.[217]

A decision by the Bankruptcy Court for the Western District of Tennessee analyzing section 365(b) suggests that any default will trigger a debtor's responsibility to provide adequate assurance of future performance. In *In re Rachels Industries, Inc.*, the debtor sought to assume a lease of nonresidential real property owned by the City of Memphis. The bankruptcy court noted that "where there has been *no* default, the provision of adequate assurance of future performance is not necessary."[218] The court therefore analyzed the lease to determine whether there had been a default.[219] The court noted the debtor's arguments that certain defaults were "mere 'technical' defaults" that did not trigger section 365(b).[220] The court disagreed with this position, stating that:

> [T]here appears to be a consensus that adequate assurance of future performance must be provided with respect to *all* of the covenants of the agreement sought to be assumed given that section 365(b)(1) requires compliance with all elements under its subparts (A), (B), *and* (C), and section 365(b)(1)(C) requires, by its terms, 'adequate assurance of future performance *under such contract or lease*.' (Emphasis added). Therefore, '[r]egarding a lease covenant to pay

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[216] *See, e.g.*, Streets & Beard Farm P'ship v. Streets (*In re* Streets & Beard Farm P'ship), 882 F.2d 233, 235 (7th Cir. 1989) (stating courts look to state law to determine significance of remaining performance due under contract); *see also In re* Rachels Indus., Inc., 109 B.R. 797, 803–04 (Bankr. W.D. Tenn. 1990) ("Federal law determines the definition of executory contracts and leases, but as to whether a default exists under a contract or lease, this Court must look to state law."); *In re* Carlisle Homes, Inc., 103 B.R. 524, 537 (Bankr. D.N.J. 1988) (explaining state law governs whether contract was terminated pre-petition). Federal law also plays a part in determining whether a default is enforceable. For example, in *In re Great Northwest Recreation Center, Inc.* the court determined that a clause dealing with the debtor's lack of credit was unenforceable under section 365(b)(2)(A) and that therefore any default under such a clause did not count as a default under section 365(b)(1). 74 B.R. 846, 855 (Bankr. D. Mont. 1987).

[217] This article discusses when and how defaults trigger a debtor's obligations to provide adequate assurance of future performance under section 365(b). This is not, however, the only provision under section 365(b) dealing with defaults. A debtor generally is required to cure all defaults before assuming an agreement. This general obligation is qualified by sections 365(b)(1)(A) and 365(b)(2). Section 365(b)(1)(A) provides that a debtor is not required to cure certain defaults arising from a failure to perform certain nonmonetary obligations. This section was amended in 2005 by the Bankruptcy Abuse Prevention and Consumer Protection Act. In the relatively short amount of time since those amendments, commentators have weighed in on how courts will interpret section 365(b)(1)(A). *See, e.g.*, Risa Lynn Wolf-Smith, *Bankruptcy Reform and Nonmonetary Defaults – What Have They Done Now?*, AM. BANKR. INST. J., Aug. 2005, at 6 (discussing 2005 amendments to section 365(b)(1)(A)). While this has the potential to be an issue of vital importance for a debtor seeking to assume an agreement, a detailed discussion of section 365(b)(1)(A) is outside the scope of this article.

[218] *In re Rachels*, 109 B.R. at 803.

[219] *See id.* at 802–03 (enumerating three-part test used to determine if there was default).

[220] *See id.* at 811 (stating, rather, default is "clear and material" and must be cured).

> rent, the test [has been] whether it appears that the rent will be paid and *other obligations thereunder met*.'[221]

The court held that, because section 365(b)(1) requires the debtor to meet every obligation under an agreement, "only one default is necessary in order to trigger [section] 365(b)(1)."[222]

To the extent that the *Rachels Industries* case stands for the proposition that any default triggers a debtor's obligation to provide adequate assurance of future performance, the case law does not support the consensus noted by the court.[223] The majority viewpoint appears to be that, as to a debtor's various obligations under section 365(b), not all defaults are treated equally. In one of the earliest decisions analyzing section 365(b), the Bankruptcy Court for the Southern District of New York discussed this issue in the context of addressing the steps that a debtor must take to provide the non-debtor party with the requisite benefit of the bargain. In *In re Evelyn Byrnes, Inc.*,[224] a clothing retailer debtor sought to assume and assign the lease for its store located on New York City's Park Avenue.[225] The debtor was a high-end retailer of women's clothing and the proposed assignee ("Labels for Less") was a discount retailer. A dispute arose between the debtor and the landlord over a use provision in the lease that required any retail tenant to comply with certain "high caliber" and "high standard" clauses in the lease.[226] The court therefore analyzed whether Labels for Less would be in default under these clauses if the lease were assigned to it.

The court began its analysis with a discussion of the legislative history of section 365(b).[227] The court noted that "Congress equated 'adequate assurance' with that which will give the landlord the full benefit of his bargain."[228] How a debtor goes about demonstrating that it is preserving the landlord's benefit of its bargain is not spelled out in the Bankruptcy Code. But, the court went on to note that, by enacting section 365(b):

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[221] *Id.* at 803 (quoting *In re* Natco Indus., Inc., 54 B.R. 436, 440 (Bankr. S.D.N.Y. 1985)).

[222] *See id.* at 810–11. The court ultimately concluded that the debtor had not met its burden under section 365(b)(1) based largely on the fact that there were significant maintenance obligations under the lease and the debtor's secured lender had withdrawn its support. *See id.* at 811.

[223] Note, however, that the *Rachel Industries* case is not the only decision suggesting that any default will trigger a debtor's responsibilities under section 365(b). *See, e.g., In re* Grayhall Res., Inc., 63 B.R. 382, 385 (Bankr. D. Colo. 1986) (explaining conditions imposed on debtor when there is any default); *In re Natco*, 54 B.R. at 440–41 (stating section 365(b) requires debtor provide adequate assurance to landlord after default); *In re* U.L. Radio Corp., 19 B.R. 537, 541–42 (Bankr. S.D.N.Y. 1982) (highlighting section 365(b) mandates debtor cures "any" default and provides adequate assurance before debtor can assume lease).

[224] 32 B.R. 825 (Bankr. S.D.N.Y. 1983).

[225] *See id.* at 827.

[226] *Id.* at 831. The landlord noted that other Labels for Less stores used track lighting, chrome fixtures, and clothing racks, which was in contrast to the "salon" style of the debtor's store. *See id.* at 828.

[227] *See id.* at 828–29.

[228] *Id.* at 829.

> Congress did not mandate that the courts require the assignee to literally comply with each and every term of the lease . . . . [Rather, Congress] has entrusted to the courts the determination, on a case-by-case basis, of the meaning of the term 'adequate assurance', taking into account whether the landlord's opposition to the assignment is 'based upon reason and . . . [is] not . . . arbitrary or capricious . . . . Such a determination is, nevertheless, to be made in light of Congress' express policy of favoring assumption and assignment as a means of continuing performance and realizing value and thereby assisting the debtor in its rehabilitation or liquidation.[229]

Therefore, the framework provided by *Evelyn Byrnes* indicates that a court should not inspect the lease to determine each and every default and thereafter require the debtor to provide adequate assurance of future performance for each default. Instead, a court should consider the overriding policy goal of section 365(b) – preserving the benefit of the bargain – and should analyze whether the alleged default at issue has a material effect on that bargain.[230]

The court also carefully noted that the favorable attitude toward assumption and assignment does not indicate that use clauses are meaningless or that a court has unlimited power to write such clauses out of an assumed lease.[231] The court stated that the individual facts of the case will determine the significance of a use

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[229] *Id.*

[230] *See id.* at 829 (stating landlord must show he would incur substantial detriment from deviation of strict enforcement of use stipulated in lease); *see also In re* Brentano's, Inc., 29 B.R. 881, 883 (Bankr. S.D.N.Y. 1983) ("[P]rovision of adequate assurance of the full benefit of the bargain 'does not require an assignee's literal compliance with each and every term of the lease.'") (quoting *In re* U.L. Radio Corp., 19 B.R. 537, 544 (Bankr. S.D.N.Y. 1982)).

[231] *See In re Evelyn Byrnes*, 32 B.R. at 830 (stating moderation is contemplated by Bankruptcy Code); *see also In re* Fleming Cos., 499 F.3d 300, 305 (3d Cir. 2007) ("Congress has suggested that the modification of a contracting party's rights is not to be taken lightly. Rather, a bankruptcy court . . . must be sensitive to the rights of the non-debtor contracting party . . . and the policy requiring that the non-debtor receive the full benefit of his or her bargain." (quoting *In re* Joshua Slocum Ltd., 922 F.2d 1081, 1091 (3d Cir. 1990))); Dewey Ranch Hockey, LLC, 406 B.R. 30, 36–37 (Bankr. D. Ariz. 2009) (refusing to allow debtors to assume and assign NHL hockey agreement that would have resulted in moving Phoenix Coyotes hockey team to Canada because agreement required Coyotes to play all home games in Arizona; the court held if team were moved, debtors could not adequately assure future performance of this term). Note that the *Joshua Slocum* court was discussing modification of a shopping center lease. While the point made by the court in *In re Fleming* (that modification of a contract should not be taken lightly) is valid in any context, it should be noted that different standards are applied in cases involving shopping center leases. For an early commentary on this issue, see Barbara A. Krupa, *The Enforceability of Use Restrictions in Assignments of Non-Shopping Center Nonresidential Leases Under Bankruptcy Law*, 57 TEMP. L.Q. 821, 829–30 (1984) (noting original differences in approach in determining adequate assurance for section 365(b) and 365(f) for shopping center leases); *see also In re U.L. Radio Corp.*, 19 B.R. at 544 (noting "insubstantial" standard for shopping center leases in section 365 of the Code, which was not intended to apply to non-shopping center leases); section IV.B, *infra*, discussing the tension between sections 365(b)(3) and 365(f)(1).

clause.[232] As to the specific facts of this case, the *Evelyn Byrnes* court noted that the lease clauses were not clear on what constituted a "high caliber" or "high standard" retailer.[233] The court ultimately held that the lease could be assumed and assigned, even if Labels for Less otherwise would have been in default under the use clauses because "[l]ack of elegance simply is not the type of harm envisioned by Congress."[234]

In a more recent decision, the Third Circuit also held that a debtor is not required to provide adequate assurance of future performance for every term of an agreement. In *In re Fleming Cos.*,[235] a grocery store distributor debtor sought to assume and assign a supply agreement.[236] The agreement required that all products shipped to Albertson's grocery stores be shipped from a particular facility in Tulsa, Oklahoma.[237] This was no longer possible because the debtor rejected the lease on that facility.[238] The proposed assignee provided evidence that it could ship products to Albertson's from other facilities.[239] In determining whether to allow the

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[232] *In re Evelyn Byrnes*, 32 B.R. at 829 (noting Congress intended for courts to make case-by-case determination of "whether the landlord's opposition to the assignment is 'based upon reason and . . . [is] not . . . arbitrary or capricious'"). "In the application of the equity contemplated by the Code to each individual case, moderation is all. The outer bounds would obviously be crossed were a debtor to seek to assign to a massage parlor a lease prohibiting use detrimental to the building . . . ." *Id.* at 830 (citing *In re* Lafayette Radio Elecs. Corp., 9 B.R. 993, 1002 (Bankr. E.D.N.Y. 1981)).

[233] *Id.* at 832 (stating terms "high caliber" or "high standard" can denote some inferences, but are too ambiguous to determine breach). For example, the lease did not expressly prohibit a discount retailer from operating in the space. Moreover, the lease did not use the term "salon" as "a term of limitation in describing the use or decoration of the store . . . ." *See id.* at 828. The court also pointed out that section 365(b) is structured such that use clauses in shopping centers are analyzed under a different standard. For a discussion of this issue, see section IV.B, *infra*. In the context of this case, which did not involve a shopping center, the court interpreted the higher standards under section 365(b)(3) to mean that courts are given greater flexibility as to use clauses in non-shopping center cases. *See id.* at 830; *see also In re* Martin Paint Stores, 199 B.R. 258, 263 (Bankr. S.D.N.Y. 1996) ("At least in the non-shopping center case, 'adequate assurance' does not require literal compliance with a use clause . . . .").

[234] *In re Evelyn Byrnes*, 32 B.R. at 831. The landlord had conceded that Labels for Less had the financial ability to perform under the lease. *See id.* at 829. It therefore was satisfactory to the court, from the perspective of section 365(b), that it would receive the rent due under the lease and that such payments provided the landlord with the benefit of its bargain. *See id.* at 828–30. This is in accordance with other cases holding that, in the context of a lease assumption, the "chief determinate of adequate assurance of future performance is whether rent will be paid." *In re* Bygraph, Inc., 56 B.R. 596, 605 (Bankr. S.D.N.Y. 1986); *see also In re* Embers 86th St., Inc., 184 B.R. 892, 902 (Bankr. S.D.N.Y. 1995) ("In assessing adequate assurance of future performance under § 365(b)(1)(C), '[t]he test is not one of guaranty, but simply whether it appears that the rent will be paid and other obligations met.'" (quoting *In re* THW Enters., *Inc.*, 89 B.R. 351, 357 (Bankr. S.D.N.Y. 1988))); *cf. In re* Coffman, 393 B.R. 829, 834 (Bankr. S.D. Ohio 2008) (stating, in chapter 13 case, "adequate assurance of future performance is typically accomplished . . . by providing for the regular contract payments through the plan"). *But see In re* Fulton Air Serv., Inc., 34 B.R. 568, 573 (Bankr. N.D. Ga. 1983) (noting where debtor sought to assume and assign lease of airport space, "due to the governmental regulation of the leasehold, adequate assurance of performance does not rest alone on the ability of the assignee to pay rent").

[235] 499 F.3d 300 (3d Cir. 2007).

[236] *See id.* at 302.

[237] *Id.* (specifying "Tulsa Facility").

[238] *Id.* at 303.

[239] *Id.* (proposing shipments from Kansas City warehouse).

agreement to be assumed and assigned in spite of this clause, the court stated that "the focus is rightly placed on the importance of the term within the overall bargained-for exchange; that is, whether the term is integral to the bargain struck between the parties (its materiality) and whether performance of that term gives a party the full benefit of its bargain (its economic significance)."[240] The court ultimately concluded that the Tulsa facility term met these requirements and therefore upheld the lower courts' decisions that the agreement could not be assumed and assigned.[241]

The majority rule, therefore, is that a debtor is only required to provide adequate assurance of future performance for terms in an agreement that is integral to preserving the full benefit of the bargain with the non-debtor party.[242] If a court determines that a term is not an integral means to this policy end, then section 365(b) does not apply. Furthermore, the court will permit the assignment of the agreement free from the confines of the non-integral terms. It should be noted,

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[240] *Id.* at 306–07 (citing cases where term may not be inherently material or obviously economic, but still integral to contract as in, for example, a "time is of the essence" clause).

[241] *Id.* at 308 (concluding supply from Tulsa Facility was "material and economically significant" term in contract). The holding was largely based on the fact that the use of the Tulsa facility was a significant element in the bargain struck with Albertson's. The facility was formerly owned by Albertson's and Albertson's was able to continue using the electronic ordering systems and ordering codes that were in place at the facility. *See id.* at 302–03. Therefore, Albertson's had demonstrated to the court's satisfaction that it was not arbitrarily opposing the assumption and assignment. Moreover, the proposed assignee did not provide any evidence "that would lead to an opposite conclusion" on the matter. *See id.* at 307.

[242] *Id.* at 305 (discussing requirement of providing adequate assurance); Cinicola v. Scharffenberger, 248 F.3d 110, 120 (3d Cir. 2001) (discussing what constitutes adequate assurance); *In re* Carlisle Homes, Inc., 103 B.R. 524, 538 (Bankr. D.N.J. 1988) ("The phrase 'adequate assurance of future performance,' adopted from section 2-609(1) of the Uniform Commercial Code, is to be given a practical, pragmatic construction based upon the facts and circumstances of each case."). A body of case law also has developed dealing with terms providing that a default in a separate agreement is considered a default in the agreement sought to be assumed – known as "cross-default" provisions. A number of cases have held that cross default provisions are enforceable, "in certain circumstances in order to give the parties the benefit of their original bargain." 6 NORTON J. BANKR. L. & PRAC. 3d, § 119:13 (2009) (discussing enforceability of cross-default provisions in multiple leases to ensure benefit of bargain); *see, e.g.*, Lifemark Hosps., Inc. v. Liljeberg Enters., Inc. (*In re* Liljeberg Enters., Inc.), 304 F.3d 410, 444–45 (5th Cir. 2002) (enforcing cross-default provision); *In re* Kopel, 232 B.R. 57, 65–66 (Bankr. E.D.N.Y. 1999) (discussing circumstances where courts enforce or refuse to enforce cross-default provisions). Certain cases touching on adequate assurance of future performance also discuss the issue of when a cross-default provision is, and is not, enforceable. *See, e.g., In re Liljeberg Enters.*, 304 F.3d at 444–46 (providing non-enforcement of cross-default provision would undermine bargain); *In re* Buffets Holdings, Inc., 387 B.R. 115, 124 (Bankr. D. Del. 2008) (noting "cross-default provisions are not per se invalid under section 365."); *In re* UAL Corp., 346 B.R. 456, 468–69 (Bankr. N.D. Ill. 2006) ("Courts applying the cross-default rule have sought to determine whether agreements linked by a cross-default clause are substantially connected to one another, so that a failure to enforce the clause would deprive the nondebtor party of an essential part of its bargain."); *In re* Convenience USA, Inc., No. 01-81478, et al., 2002 WL 230772, at *7 (Bankr. M.D. N.C. Feb. 12, 2002) (stating cross-default provisions unenforceable in bankruptcy where they would "restrict the debtor's ability to fully utilize the provisions of § 365"); *In re Kopel*, 232 B.R. at 63 (positing one must balance bankruptcy policies to decide whether cross-default provision is enforceable); *see also* Alan N. Resnik & Brad Eric Scheler, *The Effect of a Cross-Default Provision on the Ability to Assume an Executory Contract or Unexpired Lease*, 32 U.C.C. L.J. 338, 340–42 (2000) (discussing bankruptcy court's analysis in enforcing cross-default provision). These cases raise issues – such as whether the clauses are integrated and whether the other agreement is severable – that are outside the scope of this article.

however, that the cases discussing this "majority rule" deal with agreements not subject to the heightened requirements of section 365(b)(3). Section 365(b)(3), dealing with shopping center leases, imposes a much higher standard for determining whether a lease may be assigned over and above restrictive "use" clauses.

IV. HEIGHTENED ADEQUATE ASSURANCE OF FUTURE PERFORMANCE REQUIREMENTS FOR SHOPPING CENTER LEASE – SECTION 365(B)(3)

A. What is a "Shopping Center"?

As noted previously in Part II of this article, Bankruptcy Code sections 365(b)(3)(A) – (D) set forth specific requirements for demonstrating adequate assurance of future performance when a debtor is seeking to assume a shopping center lease.[243] These requirements establish a significantly higher standard for shopping center lessees, thus making it more difficult for a debtor to establish adequate assurance of future performance. As indicated by the legislative history of section 365(b)(3), the section was designed for the express purpose of ensuring that only truly financially viable debtors will be allowed to assume such a lease.[244] This is due in large part to the fact that shopping center lessors depend on a steady stream of income from their tenants to fund operating expenses and mortgage payments.

Because the standard under section 365(b)(3) is significantly higher than under section 365(b)(1), it is not uncommon for the parties to litigate vigorously the issue of whether the real property at issue is a "shopping center." Just as with the term adequate assurance of future performance, the Bankruptcy Code does not define the term "shopping center." A small amount of case law has addressed the issue, starting with cases decided in 1985. However, a case decided by the Third Circuit in 1990, *In re Joshua Slocum*,[245] provides the most detailed analysis of the factors to be considered when deciding whether a property is a shopping center under section 365(b)(3).

In re Joshua Slocum involved a retail debtor that sought to assume and assign a lease of a store located in a series of interconnected stores in the downtown shopping district of Freeport, Maine.[246] The landlord argued that the property was a shopping center and, therefore, that the assignee would be subject to a use provision

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[243] *See* discussion, *supra* Part I and II; 11 U.S.C. § 365(b)(3) (2006) (defining requirements for adequate assurance of future performance of shopping center lease).

[244] H.R. REP. No. 95-595, at 347–48 (1977) (requiring trustee to cure any default and provide adequate assurance of future performance); *see* Trak Auto Corp. v. West Town Center (*In re* Trak Auto Corp.), 367 F.3d 237, 242–43 (4th Cir. 2004) ("Congress has been interested in the financial well-being of shopping centers since at least the late 1970s."); *see, e.g.*, Battershall, *supra* note 39, at 331–32 (recognizing risk to shopping mall owners when premises were leased to tenant debtors).

[245] 922 F.2d 1081 (3d Cir. 1990).

[246] *See id.* at 1083.

dealing with a minimum amount of gross sales.[247] The bankruptcy court disagreed, holding that the property was not a shopping center and that the gross sales provision was unenforceable as an anti-assignment provision under section 365(f)(1).[248] The district court affirmed.[249] The landlord appealed to the Third Circuit, which, after analyzing the particular attributes of the property, reversed the district court and held that the property was a shopping center under section 365(b)(3).[250] To determine which factual elements were significant for making this determination, the court reviewed prior case law discussing section 365(b)(3).[251] The court used these holdings to distill an extensive list of elements to be considered:

> (a) A combination of leases;
> (b) All leases held by a single landlord;
> (c) All tenants engaged in the commercial retail distribution of goods;
> (d) The presence of a common parking area;
> (e) The purposeful development of the premises as a shopping center;
> (f) The existence of a master lease;
> (g) The existence of fixed hours during which all stores are open;
> (h) The existence of joint advertising;[sic][252]
> (j) Contractual interdependence of the tenants as evidenced by restrictive use provisions in their leases;
> (k) The existence of percentage rent provisions in the leases;
> (l) The right of the tenants to terminate their leases if the anchor tenant terminates its lease;
> (m) Joint participation by tenants in trash removal and other maintenance;
> (n) The existence of a tenant mix; and
> (o) The contiguity of the stores.[253]

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[247] *See id.* at 1092.

[248] *See id.* at 1087; *see also* 11 U.S.C. § 365(f)(1) (2006) (addressing restrictions on assignment).

[249] *See In re Joshua Slocum*, 922 F.2d at 1084. The district court affirmed on mootness grounds and did not substantively address the issue of whether the property was a shopping center. *See id.*

[250] *See id.* at 1087; *see also* 11 U.S.C. § 365(b)(3) (discussing elements of adequate assurance of future performance of lease of real property in shopping center).

[251] *In re Joshua Slocum*, 922 F.2d at 1087 (noting two cases addressing what constitutes "shopping center" for purposes of section 365(b)); *see also In re* Goldblatt Bros., Inc., 766 F.2d 1136, 1141 (7th Cir. 1985) (suggesting presence or absence of typical shopping center indicia helps determine whether premise is shopping center); *In re* 905 Int'l Stores, Inc., 57 B.R. 786, 788 (Bankr. E.D. Mo. 1985) (relying on absence of contractual interdependence among tenants as factor determining whether arrangement is shopping center).

[252] The text of the decision leaves out the letter (i). *In re Joshua Slocum*, 922 F.2d at 1087.

[253] *Id.* at 1087–88.

Applying these factors to the case at hand, the *Joshua Slocum* court noted facts indicating that the property was a shopping center, including a common landlord, a shared parking area, and the physical continuity of the stores.[254]

The landlord testified that the property was located downtown and did not "look like a shopping center."[255] The bankruptcy court's decision was also based, in part, on the fact that the parking lot was not exclusive to the property[256] and that there was no master lease.[257] The Third Circuit noted these factors, but held that the property was a shopping center, based largely on the fact that the property was a retail establishment with a common landlord.[258] Therefore, while the Third Circuit developed an impressive-looking 14-element list, it appears that the most important element is that the property has multiple retail locations sharing the same landlord.

The specific facts of the cases the *Joshua Slocum* court used to develop its list of elements also help to shed light on what will, and what will not, be considered a shopping center. The *Joshua Slocum* court relied principally on two cases decided in 1985: *In re Goldlbatt Bros., Inc.* and *In re 905 International Stores, Inc.* In *In re Goldblatt*,[259] the Seventh Circuit affirmed a decision finding that a property was not a shopping center for the purposes of section 365(b)(3).[260] The property in question had certain attributes suggesting that it was a shopping center, including "common ownership of contiguous parcels, the existence of an 'anchor tenant' [the debtor] and joint off-street parking adjacent to all stores."[261] Nevertheless, the bankruptcy court held that these attributes were insufficient to demonstrate that the property was a shopping center, noting that they were "sufficiently broad to include many commercial buildings containing two or more tenants that clearly are not shopping centers."[262] The bankruptcy court also noted that the landlord failed to offer proof that the property was "purposefully developed" as a shopping center.[263] The Third Circuit agreed with the bankruptcy court's analysis. The court acknowledged that

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[254] *See id.* at 1088.

[255] *See id.* (finding bankruptcy court gave undue weight to testimony about physical attributes of property). The Third Circuit countered that "the appearance of premises or their location within a downtown shopping district has not been cited as a factor in the determination of whether a group of stores is a 'shopping center.'" *Id.*

[256] *See id.* (noting other stores' patrons used parking lot located behind property). A city ordinance required that the general public be given access to the parking lot. *Id.*

[257] *See id.*

[258] *Id.* ("[T]he most important characteristic will be a combination of leases held by a single landlord, leased to commercial retail distributors of goods, with the presence of a common parking area." (quoting 2 COLLIER ON BANKRUPTCY, ¶ 365.04[3]) (Alan N. Resnick et al. eds., 15th ed. rev. 2006))).

[259] 766 F.2d 1136 (7th Cir. 1985).

[260] *See id.* at 1141 (concluding evidence regarding whether debtor was tenant in shopping center was "significant" but not "determinative"); *see also* 11 U.S.C. § 365(b)(3) (2006) (setting forth rules for shopping center leases).

[261] *In re Goldblatt Bros., Inc.*, 766 F.2d at 1140.

[262] *Id.* at 1141; *see also* John T. Brooks, *Shopping Center Tenants in Bankruptcy: The Effect of the 1984 Code Amendments*, 1988 U. ILL. L. REV. 725, 735 (1988) (noting definition of shopping center for purposes of section 365(b)(3) must not be so broad as to allow owners of random clusters of buildings to invoke special statutory protections).

[263] *See In re Goldblatt Bros.*, 766 F.2d at 1140.

the attributes described by the landlord were significant, but not determinative.[264] In addition to finding evidence that the property was developed as a shopping center, the court stated that certain attributes were "noticeably absent," such as: "a master lease, fixed hours during which the stores are all open, common areas or joint advertising . . . ."[265]

The court in *In re 905 International Stores, Inc.*[266] also refused to find that the property at issue was a shopping center.[267] This case is notable because the property actually called itself a shopping center.[268] In addition, the property had common marketing and a newsletter.[269] The court noted these factors, but held that "an examination of the actual legal relationships among the various tenants . . . demonstrates the absence of the contractual interdependence that Congress considered the 'linchpin' of the typical shopping center."[270] Specifically, the property lacked use restrictions, fixed hours of operations, common areas, or a master lease.[271] The *905 International Stores* case therefore stresses that a court deciding the issue should focus on the contractual relationships, rather than on more superficial indicators, such as what the property is called or its general appearance. Subsequent case law and commentaries agree with this approach.[272]

B. Enforcing Use Provisions – Section 365(b)(3) Versus Section 365(f)(1)

In addition to the issue of whether a property is a shopping center, case law analyzing section 365(b)(3) has clarified several other relatively minor points. For example, it is well established that, pursuant to section 365(b)(3)(A), the proponent of assumption must be able to demonstrate the source of payment of future rent and

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[264] *See id.* at 1141.

[265] *See id.*

[266] 57 B.R. 786 (Bankr. E.D. Mo. 1985).

[267] *See id.* at 789 (holding indicia of shopping centers were not present).

[268] *See id.* at 788 (noting lessors had filed restrictive covenants included language identifying lessors' property as shopping center).

[269] *See id.*

[270] *Id.*

[271] *Id.* at 788–89.

[272] *See, e.g., In re* Ames Dep't Stores, Inc., 121 B.R. 160, 164 (Bankr. S.D.N.Y. 1990) (holding two buildings abutting common parking area were not shopping center, even though they looked like shopping center and called themselves shopping center, because property had no "master agreement creating common store hours, joint advertising or otherwise affording other tenants rights with respect to operating of the Lease premises"); *see also* Ramco-Gershenson Props., L.P. v. Serv. Merch. Co., 293 B.R. 169, 180 (M.D. Tenn. 2003) (affirming bankruptcy court decision holding two properties separated by major public road were separate shopping centers based, in part, on separate legal relationships between two properties); *In re* Sun TV & Appliances, Inc., 234 B.R. 356, 370 (Bankr. D. Del. 1999) (conducting analysis using *Joshua Slocum* factors and holding certain parcels located outside enclosed shopping center were included in overall shopping center for purposes of section 365(b)(3) based on fact that large number of *Joshua Slocum* factors had been established); *In re* R&J, Inc., 140 B.R. 316, 318 (Bankr. D. Mass. 1992) (stressing importance of *Joshua Slocum* factors over physical appearance of shopping center); Edward K. Esping, Annotation, *What is "Shopping Center" Within Meaning of Bankruptcy Code Provision Governing Assumption and Assignment of Debtor's Leases by Bankruptcy Trustee (11 U.S.C.A. § 365(b)(3))*, 117 A.L.R. FED. 321 (1994) (discussing various cases applying statutory text of section 365(b)(3)).

other consideration under the lease,[273] and must establish that any proposed assignee is in similar financial condition to the condition of the debtor at the time the shopping center lease was executed.[274]

In addition, adequate assurance of future performance, as defined under section 365(b)(3), must be provided in the case of a shopping center, whether or not there has been a default under the lease. The substantive issue generating the most discussion by courts and commentators, however, is whether a court will enforce use provisions in a shopping center lease. The plain language of section 365(b)(3)(C) indicates that a debtor must provide specific assurances that such use provisions will be maintained not only in the debtor's lease, but also in leases for other properties within the shopping center. Specifically, the debtor must demonstrate:

> that assumption or assignment of such lease is subject to all the provisions thereof, including (but not limited to) provisions such as radius, location, use, or exclusivity provision, and will not breach any such provision contained in any other lease, financing agreement, or master agreement relating to such shopping center . . . .[275]

As discussed, section 365(b)(3) was amended twice to strengthen this provision, thus demonstrating its importance to both landlords and Congress. On its face, a use provision clearly acts as a restriction on the assignment of a lease. For example, if the shopping center lease restricts the space to a furniture retailer, it seems clear that section 365(b)(3) would prohibit assignment of the lease to a pet store. This would be in spite of how much the pet store would be willing to pay for the lease, and in spite of how much that money would assist in the debtor's reorganization. However, the plain language of section 365(f)(1) provides that such "anti-assignment" provisions are unenforceable in bankruptcy. Section 365(f)(1) reads:

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[273] *See* 11 U.S.C. § 365(b)(3)(A) (2006) (stating adequate assurance requires showing of source of rent); *see, e.g., In re* OK KWI Lynn Candles, Inc., 75 B.R. 97, 101–02 (Bankr. N.D. Ohio 1987) (refusing to allow assumption of shopping center lease because debtor provided no evidence of source of payment of rent, aside from "continued operation of its business . . . ."); *In re* Tech Hifi, Inc., 49 B.R. 876, 879 (Bankr. D. Mass. 1985) ("Adequate assurance of future performance with respect to the source of rent to be paid means that the proposed assignee has the ability to satisfy the financial obligations imposed by the lease . . . An absolute guarantee, such as a letter of credit, is not required to meet this standard." (citing *In re* Alipat, Inc., 36 B.R. 274, 278 (Bankr. D. Mo. 1984))).

[274] *See* 11 U.S.C. § 365(b)(3)(A); *In re* Serv. Merch. Co., 297 B.R. 675, 686 (Bankr. M.D. Tenn. 2002) (authorizing assumption and assignment of lease because assignee's financials were at least as strong as Service Merchandise's financials in 1980, when lease was signed); *In re* The Casual Male Corp., 120 B.R. 256, 264 (Bankr. D. Mass. 1990) ("Section 365(b)(3)(A) requires that 'the financial condition and operating performance' of [the proposed assignee] 'be similar' to that of the Debtors at the time the lease was executed.").

[275] 11 U.S.C. § 365(b)(3)(C).

> Except as provided in subsections (b) and (c) of this section, notwithstanding a provision in an executory contract or lease of the debtor, or in applicable law, that prohibits, restricts, or conditions the assignment of such contract or lease, the trustee may assign such contract or lease under paragraph (2) of this subsection [which requires that the assignee provide adequate assurance of future performance].[276]

The first clause of section 365(f)(1) ("[e]xcept as provided in subsections (b) and (c)") indicates that the use provisions protected by section 365(b)(3) are not affected by section 365(f)(1). Not all cases addressing the issue, however, agree that the issue is so straightforward.

The line of cases supporting the view that section 365(b)(3) trumps section 365(f)(1) begins, once again, with the *Joshua Slocum*[277] case. After holding that the subject property was a shopping center, the court overruled the bankruptcy court's decision that a certain provision in the lease was unenforceable under section 365(f)(1). The provision stipulated that either the landlord or the tenant could terminate the lease if certain gross sales were not reached. The court held that this provision was an essential element of the landlord's bargain and that, "[i]n excising [the provision], the bankruptcy court undermined both Congressional policy and the statutory requirement under section 365(b)(3)(A) that the trustee give adequate assurance of 'other consideration due' under an unexpired lease."[278]

A more substantive analysis of the issue was made by the Bankruptcy Court for the District of Delaware in *In re Sun TV & Appliances, Inc.*[279] In this case, the court considered whether certain use provisions would be enforceable against an assignee of a shopping center lease. The provisions required that, during the first fifteen years of the lease, the premises be used only for the sale of certain electronics and appliances.[280] Furthermore, the lease specifically prohibited the operation of certain types of stores, including discount department stores.[281] The debtor argued that these provisions were anti-assignment provisions prohibited under section 365(f)(1) and that it should be allowed to assign the lease free from the restrictions.[282] The court disagreed, holding that shopping center use provisions such as these were accorded special significance by Congress in section 365(b)(3).[283] The court specifically noted that section 365(b)(3) "evidence[s] Congress' belief that use

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[276] 11 U.S.C. § 365(f)(1).

[277] 922 F.2d 1081 (3d Cir. 1990).

[278] *See id.* at 1091 (adding modification of contracting parties right not to be taken lightly).

[279] 234 B.R. 356 (Bankr. D. Del. 1999).

[280] *See id.* at 366.

[281] *See id.* (describing restrictive use provisions in lease). The restrictive prohibitions were particularly specific, prohibiting the operation of a bookstore, jewelry store, or music store. *See id.*

[282] *See id.* at 370 (arguing Congress did not intend "literal compliance" with lease provisions); *see also* 11 U.S.C. § 365(f)(1) (2006) (stating trustee may assign contract except as provided in certain circumstances).

[283] *See In re Sun TV & Appliances, Inc.*, 922 F.2d at 370 (noting Congress believed such restrictions essential with shopping center leases). *See generally* 11 U.S.C. § 365(b)(3)(C).

restrictions and tenant mix in shopping center leases are material." The court went on to write:

> [T]he Code's treatment of use provisions in shopping center leases undercut the Debtor's argument that they are 'insubstantial.' Rather, those provisions are at the heart of the interdependence of shopping center leases, as recognized by Congress in requiring an assignee to demonstrate an ability to adhere to them. They are crucial to the tenant mix, which is designed to attract the right number and mix of customers to the mall. Thus, we conclude that section 365(b)(3) does not permit them to be stricken, even where (as the Debtor asserts) they prevent the Debtor from selling the Lease.[284]

The court therefore made it very clear that the landlord protections of section 365(b)(3) trump concerns that a bankruptcy court might normally be expected to have about provisions that prevent a debtor from maximizing the sale value of a lease.[285]

The Fourth Circuit also subscribes to this viewpoint. In *In re Trak Auto Corp.*,[286] the court held that a use provision in a shopping center lease prevented the debtor from assigning the lease to a discount clothing retailer.[287] The lease had a restrictive use provision requiring that the space be used only for an automobile parts and accessories store.[288] The bankruptcy court held that this provision was unenforceable under section 365(f)(1), and the district court affirmed.[289] The Fourth Circuit conducted a detailed analysis of the legislative history of section 365(b)(3) and held that the restrictive use provision was enforceable under section 365(b)(3)(C).[290] The court noted that the bankruptcy court's decision was based in part on the bankruptcy court's determination that the local market did not need another auto parts retailer.[291] The bankruptcy court conducted an evidentiary hearing on the matter, and concluded that only 59 percent of people in the area owned cars and that there were already seven other auto parts retailers within three miles of the shopping center.[292] The Fourth Circuit concluded that this market analysis was irrelevant.[293] The important issue, as far as section 365(b)(3) is

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[284] *See In re Sun TV & Appliances*, 234 B.R. at 370–71; *see also* 11 U.S.C. § 365(b)(3)(C).

[285] *See In re Sun TV & Appliances, Inc*., 234 B.R. at 371 n.7 ("[T]he value lost to the Debtor is irrelevant to our decision, since section 365(b)(3) . . . does not direct us to consider that factor.").

[286] Trak Auto Corp. v. West Town Center (*In re* Trak Auto Corp.), 367 F.3d 237 (4th Cir. 2004).

[287] *See id.* at 239 (discussing chapter 11 debtor who sought to assign shopping center lease with restrictive use provision).

[288] *See id.* at 240.

[289] *See id.* at 240–41.

[290] *See id.* at 242–44 (examining Congressional intent and legislative history of relevant sections).

[291] *Id.* at 244 (noting auto market in area was already "saturated").

[292] *Id.* at 240.

[293] *Id.* at 244 (stating rights under section 365(b)(3)(C) apply "regardless of market conditions.").

concerned, is the judgment of the landlord (expressed in the lease terms), even if that judgment is questionable. Specifically, the court stated:

> This analysis [of the bankruptcy court] overlooks the fact that . . . the shopping center landlord, made the judgment that an auto parts retailer is important to a successful mix of stores in the center. And, in its lease with [the Debtor], [the landlord] successfully negotiated to have the leased space dedicated to the sale of auto parts. [The landlord] insists that this use restriction be honored by any assignee of [the Debtor] and that is [the landlord's] right under section 365(b)(3)(C), regardless of market conditions. Section 365(b)(3)(C) simply does not allow the bankruptcy court or us to modify [the landlord's] '*original* bargain with the debtor.'[294]

The *Trak Auto Corp.* case therefore stands for the proposition that section 365(f)(1) does not authorize a court to modify the original bargain struck by the landlord of a shopping center by invalidating a restrictive use provision. Note, however, that the *Trak Auto Corp.* went on to note that section 365(b)(3) may not always trump section 365(f)(1). The court did not expand on this reasoning, but suggested that "[a] shopping center lease provision designed to prevent any assignment whatsoever might be a candidate for the application of section 365(f)(1)."[295]

Other courts have agreed that section 365(f)(1) does not allow a shopping center debtor to assign the lease free from restrictive use provisions.[296] A line of cases has developed, however, that, under the facts in those cases, come to the opposite conclusion. The most recent case adopting this reasoning is *Ramco-Gershenson Properties, L.P. v. Service Merchandise Co.*[297] The *Ramco* case analyzed a clause giving the landlord the right to purchase the property on the proposed assignment of the lease.[298] The bankruptcy court held that this was an impermissible anti-assignment provision. On appeal, the district court agreed. The court held that section 365(f)(1) prohibited the enforcement of the clause, even in the context of a shopping center lease. The court contrasted the clause at issue with

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[294] *Id.* at 244 (quoting S. REP. NO. 98–65, at 67–68 (1983)).

[295] *See id.* at 245 (quoting statement by Sen. Hatch during debate on 1984 amendments to section 365(b)(3)).

[296] *See e.g., In re* J. Peterman Co., 232 B.R. 366, 370 (Bankr. E.D. Ky. 1999) (enforcing shopping center radius provision and dismissing prospective assignee's argument that section 365(f)(1) prohibited such enforcement). *But see In re* Buffets Holdings, Inc., 387 B.R. 115, 119 (Bankr. D. Del. 2008) (stating courts will not enforce anti-assignment provisions designed solely to impair debtor's ability to assume or reject leases); *see also In re* Fleming Cos., 499 F.3d 300, 307 (3d Cir. 2007) ("Provisions which are so restrictive that they constitute *de facto* anti-assignment provisions are also rendered unenforceable.").

[297] 293 B.R. 169, 176 (M.D. Tenn. 2003) (holding lessor could not object to shopping center debtor's assignment of lease because adequate protection existed).

[298] *See id.* at 174 (affirming bankruptcy court's ruling that purchase option is restriction on assignment not allowed by section 365(f)).

more common use restrictions, such as "average sales clauses, radius provisions, and exclusive use provisions . . . ."[299] The *Ramco* court therefore carved this consent provision out of the clauses protected by section 365(b)(3).

The District Court for the District of Delaware has also weighed in on this issue. In *In re Rickel Home Centers, Inc.*,[300] the court considered whether a debtor operating a home improvement store in a shopping center could assume and assign its lease to Staples Office Supply. As to the dispute between sections 365(b)(3) and (f), the court opined that

> [s]ection 365(b)(3) is not meant to be read in isolation. Rather, [the section] must be read in conjunction with the section that it cross-references, [s]ection 365(f) . . . In interpreting [s]ection 365(f), courts and commentators alike have construed the terms to not only render unenforceable lease provisions which prohibit assignment outright, but also lease provisions that are so restrictive that they constitute de facto anti-assignment provisions.[301]

The court referred to uncontroverted testimony of the debtor's president and chief executive officer that the home improvement industry was distressed and that no home improvement store had expressed interest in any of the debtor's leases.[302] The court used this evidence as a basis to conclude that, considering the market, the use provision would act to prohibit any assignment and that, therefore, it was unenforceable under section 365(f)(1).[303]

The *Rickel* decision appears to be directly at odds with the *Trak Auto* decision. It was not relevant to the *Trak Auto* court that the local market could not support another auto parts store. It was entirely relevant (and dispositive) to the *Rickel* court that the local market could not support another home improvement store. The language used by the courts in their decisions suggests, however, that this is more of a factual difference than a difference over the interaction between sections 365(b)(3) and (f). The *Trak Auto* court acknowledged that a provision prohibiting

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[299] *Id.* at 175 (citing cases where courts have refused to block anti-assignment provisions). The court noted that the landlord still had the right to enforce the tenant mix provision in the lease, and that therefore "Bankruptcy Code § 365(b)(3)(D)'s concern about shopping centers' ability to protect tenant mix can be respected without allowing clauses such as this one to stand." *Id.* As to tenant mix, this was not the first time the bankruptcy court considered the issue in this bankruptcy case. In *In re Serv. Merch. Co.*, the court authorized the assignment of a Service Merchandise store lease to arts and crafts store Michaels. 297 B.R. 675, 689 (Bankr. M.D. Tenn. 2002). This assignment was made over the objection of Jo-Ann's Stores, Inc. that the assignment violated a provision in its lease regarding tenant mix and balance (Michael's and Jo-Ann's were direct competitors). *See id.* at 690. The court's decision was based largely on an interpretation of the Service Merchandise store lease, which did not specifically prohibit assignment to a competitor of another tenant in the shopping center. *See id.* at 688.

[300] 240 B.R. 826, 828 (D. Del. 1998) (stating debtor sought order authorizing sale of 41 leases).

[301] *Id.* at 831.

[302] *See id.* at 831–32 (using statements by president and chief executive officer to consider whether to enforce provisions of lease restricting use of land to "home improvement centers" only).

[303] *See id.* at 832 (calling provision in lease "de facto anti-assignment clause").

any assignment whatsoever would likely be unenforceable, even in the context of a shopping center.[304] The *Rickel* court clearly agrees with that position, and found under the facts before it, and in the relevant local market, that the practical effect of the use provision was to prohibit any assignment.

CONCLUSION

This discussion of adequate assurance of future performance case law makes it clear that determining whether the standards set out in section 365 have been met requires a fact-intensive inquiry. No two cases are ever exactly alike, and different courts may view similar facts differently. There is a sufficient amount of case law on the issue, however, to formulate the critical mass necessary to provide guidance on this otherwise murky issue of law. First and foremost, adequate assurance of future performance was written into the Bankruptcy Code to ensure that the non-debtor party to the agreement receives the benefit of its bargain – no more, no less. Shopping center landlords are given greater protection through the more specific provisions of section 365(b)(3), but these provisions are additional means to the same end – the preservation of that bargain. Aside from issues of a rather technical nature, such as who has standing to bring the issue and whether a default has occurred, the process usually will come down to a balancing of rights. Non-debtor parties are not entitled to guaranties or to windfalls. By the same token, debtors are not entitled to a free ride simply because they sought protection under title 11 and they must demonstrate the ability to live up to the obligations under the agreements. Both spectators and participants to the balancing act may witness surprising results on occasion. But, if they keep these principal policy considerations in mind, they should be able to come to an understanding of what is necessary to meet the requirements of section 365 of the Bankruptcy Code.

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[304] *See id.* at 245 (positing possibility of using section 365(f) to invalidate clause prohibiting assignment in shopping center lease); *see also* 11 U.S.C. § 365(f)(1) (2006) ("[A] provision in an executory contract or unexpired lease of the debtor, or in applicable law, that prohibits, restricts, or conditions the assignment of such contract or lease, the trustee may assign such contract or lease . . . .").